

**STATE OF WISCONSIN**

**SUMMARY OF TAX  
EXEMPTION DEVICES**

JIM DOYLE, GOVERNOR



February 2005

**Division of  
Executive Budget and Finance  
DEPARTMENT OF ADMINISTRATION**

**Division of  
Research and Policy  
DEPARTMENT OF REVENUE**



# State of Wisconsin ● DEPARTMENT OF REVENUE

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**Jim Doyle**  
Governor

**Michael L. Morgan**  
Secretary of Revenue

January 11, 2005

To members of the 2005-06 Legislature:

Every two years, the Department of Revenue is required—under section 16.425 of the Wisconsin Statutes—to prepare a summary of existing tax exemption devices. This *Summary of Tax Exemption Devices* facilitates a comprehensive review of tax exemption devices and their corresponding fiscal effects. This type of review is important if we are to keep the revenue loss associated with current state tax exemptions in perspective.

The report represents the efforts of staff in the Department of Revenue, Division of Research and Analysis. Great care has been taken to provide as accurate and complete a report as possible. The Department of Revenue hopes that members of the Legislature and others find the document to be a useful tool in the formulation of public policy decisions. Research staff in the department stands ready to answer any questions you may have concerning material in this document.

Sincerely,

A handwritten signature in black ink, appearing to read 'M. Morgan', with a stylized flourish at the end.

Michael L. Morgan  
Secretary of Revenue

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## INTRODUCTION

Wisconsin's state and local governments rely on tax revenues to fund valuable services to our citizens. Ensuring that our system of taxation is fair, equitable and efficient is vital to our economic success and quality of life. In setting tax policies, we must consider taxpayers' ability to pay, the impact of those policies on economic development, and the interaction of tax policies with other policy goals.

Tax exemptions are an important component of Wisconsin tax policies. A tax exemption is "...any tax provision that exempts, in whole or part, certain persons, income, goods, services or property from the impact of established taxes."<sup>1</sup> Granting a tax exemption can be a powerful tool for providing economic development incentives or for mitigating the regressive qualities of certain tax types. However, exemptions always come with a cost. Exemptions reduce revenues otherwise available for programs or for tax relief for taxpayers who do not benefit from the exemption. Therefore, it is critical that policymakers understand both the costs of exemptions and their effectiveness at achieving their intended goal.

Recognizing the need for this information, the legislature mandated that a report be presented biennially to the legislature listing all tax exemption devices and their fiscal effects. The first report was presented in 1975 and this is the 16<sup>th</sup> report compiled by the Department of Revenue.

### Highlights of the Report

The report is organized by tax type. For each, it describes the various exemptions that are currently authorized and provides estimates of the fiscal effects in fiscal year 2004 (FY04) where data is available. Detailed explanations of each tax type are available on the Department of Revenue web site at <http://www.revenue.wi.gov/report/index.html>.

On a case by case basis, the estimates provide a valuable benchmark for discussion of whether the policy justifications warrant the loss in revenue or if other tools, such as a direct expenditure programs, could be considered as alternatives. As the examples below demonstrate, determining the degree to which exemptions meet their policy objectives is challenging, due to the difficulty of quantifying the outcomes and in some cases needing to make assumptions regarding the underlying goal.

#### *Individual Income Tax Exemptions*

The individual income tax is the largest generator of revenues for State government. In FY04, income tax collections of \$5.28 billion represented 49% of the State General Purpose Revenue (GPR). Exemptions from the income tax include deductions or exclusions from taxable income and tax credits. A tax exclusion refers to a type of income that is not taxable and does not need to be reported on the tax return, such as income from qualifying scholarships. A deduction refers to an amount that is subtracted from total taxable income that is reported, such as a deduction for capital gains and the standard deduction. Credits are a direct reduction in the tax liability that is owed. For non-refundable credits, the credit can not exceed total tax liability. In contrast, refundable credits can exceed tax liability, resulting in a payment due to the taxpayer.

Many income tax exemptions are based on Wisconsin's consistency with federal tax policy. For example, Wisconsin conforms to the federal exclusion of payments received for sickness or injury benefits, which had an estimated cost of \$731 million for Wisconsin in FY04. While this is clearly a high cost exemption, removing the exemption would reduce the benefit of other policy programs such as worker's compensation, proceeds from insurance policies, and allowance for injuries incurred in military action.

Other income tax exclusions are unique to Wisconsin. Wisconsin exempts 50% or more of Social Security benefits depending on a recipient's filing status and income, an exemption that costs an estimated \$202 million. In contrast, the federal government exempts as little as 15% for some recipients. Adopting the same approach as the federal government would have cost an estimated \$162 million. This additional State benefit of \$40 million is targeted to Social Security recipients above the federal income threshold and does not further benefit any recipients below that income level.

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<sup>1</sup> From Wisconsin Statutes Section 16.425 (2).

An example of a refundable tax credits is the homestead credit that provides a credit to low income renters and homeowners to offset a portion of property taxes. The cost of the program in FY04 was \$120 million. The department's Tax Incidence Study released in December shows that this program is effective at reducing the regressive nature of the property tax (<http://www.dor.state.wi.us/ra/txinci04.html>). However, its parameters are not indexed for inflation, so the scope of individuals that it benefits decreases as incomes rise.

### *Sales Tax Exemptions*

Wisconsin generated \$3.90 billion in FY04 from its 5% sales and use tax, which represented 36% of state GPR. In addition, counties and professional football and baseball stadium districts are authorized to collect additional sales tax from the same tax base. Goods and services that are exempt from this tax therefore lower revenues for both the state and local governments.

One of the largest exemptions from the sales tax is the exemption for food purchased for home consumption, which was estimated to reduce State revenues by \$505 million in FY04. However, the Department of Revenue's Tax Incidence Study credits this exemption for significantly mitigating the regressivity of the sales tax. Since food items represent a larger portion of the incomes for low-income individuals, removing this exemption would have implications for health and quality of life programs.

Another significant exemption is for goods sold to other state and local governments and schools, which costs an estimated \$228 million. Removing this exemption would result in a situation where one taxing authority imposes a tax on another.

In contrast to tangible goods that are taxed unless specifically exempt in statute, services are exempt unless they are singled out for taxation. Of those services that continue to be exempt, the largest exemptions are in the areas of professional services and business services. These categories include a variety of services such as health professionals which accounts for \$384 million in foregone revenue, and legal, computer and advertising services which reduce revenues by over \$100 million each.

### *Property Tax Exemptions*

The local property tax generates more revenue than either the State sales or income tax. Property taxes collected in 2004 for taxes levied in 2003 totaled \$7.22 billion, which represents the combined levy of school districts, municipalities, counties, vocational colleges, and special districts. The state establishes policies regarding what real and personal property is subject to the local property tax, guided by the uniformity clause of the State Constitution, which prohibits differential treatment of most property including partial exemptions.

Real property that is exempt from taxation includes property owned by religious establishments, educational and medical facilities, and residential property that is owned by benevolent associations. In total it is estimated that the value of this exempt property is \$21.7 billion. There are also a number of exemptions to personal property taxation, most notably the exemption for machinery and equipment for manufacturing, which comprises an estimated value of \$11.9 billion.

If the exempt property examined in this report were taxable, property tax rates would be reduced by an estimated 10.9% statewide, ranging from a 15.7 % reduction in cities to a 3.4 % reduction in towns.

Clearly these exemptions have implications for economic development, health, housing and education policies in Wisconsin, and the impact on the property tax should be analyzed in the context of those benefits.

### *Other Exemptions*

The report also discusses exemptions relating to the corporate income tax, insurance premium taxes, recycling surcharge, real estate transfer fees, public utility taxes and forest crop and managed forest laws.

### **Limitations of the Report**

Readers should be aware of several limitations to the report.

The fiscal impacts of tax exemption devices are often difficult to measure, and estimates of them are subject to limitations and the need to make assumptions. Generally, in calculating each fiscal effect, it is assumed that only the provision in question is changed and that all other aspects of the tax system remain the same.

All of the estimates are based on the impact of the exemption devices in FY04 to allow for the use of actual data. Changes in taxpayer behavior or economic activities since that time are not reflected.

Consistent with accepted revenue estimating practices, the estimates also assume that economic variables, taxpayer behavior and other factors would be unaffected by the repeal of an exemption device. For some devices, these assumptions are open to question. For example, the removal of an income tax deduction could significantly alter spending or investment behavior.

In addition, the estimates are only as good as the data available. In some cases, the estimates are very reliable, however in other cases little data is available or we must rely on external sources. Therefore, the estimates should generally be viewed as indicative only of the order of magnitude of tax exemption costs.

Due to these data limitations and interactions between various exemptions, it is not necessarily accurate to sum across the exemptions to arrive at a total fiscal impact. Each estimate is made in isolation. If two or more items were eliminated, the combined effect may be more or less than the sum of their respective estimates.

In addition to listing tax exemption devices and estimating their impacts, the statutes require that the tax exemption report contain "policy purposes and indicators of effectiveness in achieving such purposes" for each item. As discussed above, it is difficult to determine what policy considerations prompted the enactment of each tax exemption device and to evaluate the degree to which policy goals have been achieved. Because no standard for such evaluation has been established, the department has not been able to comply with this requirement. However, the department plans to pursue the possibility of establishing evaluation criteria that could assist in future reports, particularly for some of the larger exemptions.

## INDIVIDUAL INCOME TAX

### Introduction

The individual income tax is Wisconsin's largest tax source, generating \$5,277 million, or 49% of state general purpose revenue taxes in FY04. Wisconsin first enacted its income tax in 1911 – two years before the federal income tax was imposed.

Wisconsin imposes the income tax on a base that generally conforms to the base for the federal income tax – federal adjusted gross income (FAGI) is the starting point for the Wisconsin tax calculation. FAGI is calculated on the federal return by reporting the various kinds of income – for instance, wages and salaries, interest and dividends, business earnings, retirement income – and then making adjustments for certain kinds of income or expenses. Major adjustments include:

- Contributions to individual retirement accounts and to retirement plans of self-employed persons.
- Health insurance premiums paid by the self-employed.
- One-half of the self-employment tax paid for social security and Medicare coverage.
- Up to \$2,500 in interest on student loans when income does not exceed prescribed limits.
- Alimony paid, to the extent the payments are included in the income of the recipient.

In the Wisconsin tax calculation, modifications, both additions and subtractions, are made to FAGI in the determination of Wisconsin adjusted gross income (WAGI). Additions are types of income that are exempt from federal tax but subject to state tax, or deductions allowed for federal but not Wisconsin purposes. The major addition is state and municipal bond interest, which states, but not the federal government, may tax. Another addition results from differences in the amount of capital losses that taxpayers may offset against income – \$3,000 under federal law, but \$500 under Wisconsin law. Taxpayers who deduct more than \$500 in losses for federal purposes must add back the excess in calculating WAGI. A federal deduction not allowed for Wisconsin purposes that must be added back in the calculation is the deduction for higher education expenses that is allowed from 2002 through 2005. Wisconsin did not adopt the federal deduction because it has its own tuition deduction.

Subtractions are types of income taxable under federal law but exempted by Wisconsin and certain expenses for which Wisconsin allows a deduction. Major subtractions include:

- 60% of capital gains on assets held for more than one year. These gains are fully included in federal taxable income, though long-term gains are taxable at lower rates than ordinary income.
- Interest on U.S. government bonds, which the federal government may, but states may not, tax.
- Pensions received by persons who were members of or retired from Milwaukee city and county retirement funds, the state teachers' retirement fund and the civil service retirement system prior to January 1, 1964. In addition, veterans' pensions are exempt from Wisconsin income tax.
- A portion of social security benefits that are taxable for federal purposes. Up to 85% of social security benefits are subject to federal tax, but Wisconsin limits the amount taxed to 50% of benefits.
- A portion of unemployment compensation, which is fully taxable under federal law but taxed by Wisconsin only when income exceeds \$18,000 for married couples and \$12,000 for most other filers.
- Tuition payments, up to \$3,000 per student, to post-secondary institutions in Wisconsin and to schools in Minnesota covered under Minnesota-Wisconsin tuition reciprocity.
- 50% of health insurance premiums paid by employed persons whose employer does not contribute to their health insurance.
- Premiums paid for long-term care insurance.

WAGI is reduced by a standard deduction and personal exemptions to yield Wisconsin taxable income. Wisconsin provides a sliding scale standard deduction, equal to a maximum amount when income is below a specified level; this maximum deduction is phased down to \$0 as income increases. For instance, in 2003, the deduction for single persons was \$7,790 when WAGI was less than \$11,220 and it declined to \$0 as income increased from \$11,220 to \$76,136. The deduction parameters for each filing status are shown in Table 1; the maximum deduction and phase-out range are indexed annually for inflation. Unlike federal law, Wisconsin does not allow itemized deductions; instead it provides an itemized deductions credit, discussed below, equal to 5% of certain deductions in excess of the standard deduction.

**TABLE 1  
WISCONSIN STANDARD DEDUCTIONS, 2003**

Filing Status	Maximum Deduction	Phase-Out Range	Phase-Out Rate
Single	\$7,790	\$11,220 - \$76,136	12%
Head of Household	\$10,060	\$11,220 - \$32,808*	22.515%
Married Filing Jointly	\$14,030	\$15,760 - \$86,697	19.778%
Married Filing Separately	\$6,660	\$7,480 - \$41,154	19.778%

\* Income at which head of household deduction equals the deduction for single filers. Above this income level, the deduction for heads of households is the same as that for single persons.

WAGI is also reduced by a personal exemption equal to \$700 for each tax filer, spouse and dependent. There is an additional exemption of \$250 for each tax filer and spouse age 65 or older.

Wisconsin taxable income, equal to WAGI less the standard deduction and personal exemptions, is the base to which statutory tax rates are applied to yield gross tax liability. As Table 2 shows, Wisconsin imposed a series of graduated tax rates, ranging from 4.6% to 6.75%. The top rate applies only to filers with substantial amounts of income – in 2003, on income exceeding \$126,420 for single persons and \$168,560 for married couples filing jointly. Bracket ceilings are indexed for inflation.

**TABLE 2  
WISCONSIN TAX RATES AND BRACKETS, 2003**

Tax Rate	Taxable Income Brackets		
	Single	Married – Joint	Married – Separate
4.60%	\$0 - \$8,430	\$0 - \$11,240	\$0 - \$5,620
6.15%	\$8,430 - \$16,860	\$11,240 - \$22,480	\$5,620 - \$11,240
6.50%	\$16,860 - \$126,420	\$22,480 - \$168,560	\$11,240 - \$84,280
6.75%	More than \$126,420	More than \$168,560	More than \$84,280

Finally, gross tax is reduced by credits against the tax liability. Major nonrefundable credits, which are limited to the amount of income tax liability otherwise due, include:

- The itemized deductions credit, equal to 5% of the amount by which certain federal itemized deductions exceed the standard deduction. Deductions allowed for the credit are those for medical expenses, mortgage interest on a primary residence located in Wisconsin, investment interest on securities the income from which is subject to Wisconsin tax, and charitable contributions.
- The school property tax credit, equal to 12% of the first \$2,500 of property taxes, or rent constituting property taxes, for a maximum credit of \$300. Rent constituting property taxes equals 20% of rent if heat is included in rent, and 25% if heat is not included.
- The working families credit, which eliminated tax liability below \$18,000 for married couples filing jointly and \$9,000 for other tax filers and which is phased out over the next \$1,000 of income above these amounts.
- The married couple credit for couples when both spouses are working, equal to 3% of the earnings of the lower earning spouse, but not more than \$16,000, resulting in a maximum credit of \$480.
- The credit for military income earned outside the United States, to the extent the income is included in WAGI, equal to the amount of those earnings, but no more than \$200.

- Historic rehabilitation credits, including a supplement to the federal historic rehabilitation credit equal to 5% of qualifying expenditures under the federal Internal Revenue Code and a state historic rehabilitation credit equal to 25% of qualified expenditures to substantially rehabilitate certified historic buildings.
- A credit for income taxes paid to other states on wages or other earnings in those states. No credit is allowed for states with which Wisconsin has reciprocity, that is, agreements under which each state agrees not to tax the wages earned within its borders by residents of the other state. Wisconsin has reciprocity agreements with Illinois, Indiana, Kentucky, Michigan and Minnesota. Because the number of Wisconsin residents working in Illinois and Minnesota is substantially higher than the number of residents of those states working in Wisconsin, Wisconsin annually makes a payment to those states to compensate them for the net revenue loss they incur as a result of reciprocity.

Individual income taxpayers are also eligible for business tax credits for sales tax on fuel and electricity used in manufacturing and for activities in developments zones. These credits are described more fully in the corporate income and franchise tax chapter.

In addition to nonrefundable tax credits, Wisconsin also offers refundable credits, which are paid to claimants in the form of a tax refund when the amount of the credit exceeds tax otherwise due. These credits are essentially subsidies provided to particular types of claimants through the tax system. These credits are:

- The Homestead credit, which equals up to 80% of property taxes or rent constituting property taxes when household income does not exceed \$8,000. Maximum property taxes allowable under the credit are \$1,450, so the maximum credit is \$1,160. The credit is phased out as household income rises from \$8,000 to \$24,500. Rent constituting property taxes equals 20% of rent when heat is included in rent and 25% of rent when heat is not included.
- The earned income tax credit (EITC), calculated as a percentage of the federal earned income tax credit depending on family size: 4% for persons with one child, 14% for persons with two children and 43% for persons with three or more children. In 2003, the federal credit for persons with one child was equal to 34% of earnings up to \$7,490, for a maximum credit of \$2,547. The credit for single persons was phased out as the greater of FAGI or earnings rose from \$13,730 to \$29,666; the phase-out floor and ceiling was \$1,000 higher for married couples. For persons with two or more children, the federal credit was 40% of earnings up to \$10,510, for a maximum credit of \$4,204. The credit was phased out for single persons as income or earnings rose from \$13,730 to \$33,692; the phase-out floor and ceiling were \$1,000 higher for married couples. Thus, the maximum Wisconsin credits were \$102 for persons with one child, \$589 for persons with two children and \$1,808 for persons with three or more children.
- The farmland preservation credit for owners of farmland that was zoned exclusively for agriculture use or covered under a farmland preservation agreement with the state. The credit is calculated by determining "excessive property tax" on land and improvements, which is the amount of property taxes less a portion of household income in excess of \$5,000 (ranging from 7% of household income between \$5,000 and \$10,000 to 37% of household income in excess of \$30,000). "Excessive property tax" is limited to \$6,000 and the potential credit is equal to 90% of the first \$2,000 of excessive property taxes, 70% of the next \$2,000 and 50% of the remaining \$2,000, for a maximum potential credit of \$4,200. The amount of credit actually received is 70%, 80%, 95% or 100% of the potential amount, depending on whether the claimant participates in the farmland preservation program through zoning or a contract and depending on the action taken on a farmland preservation plan or zoning by the county or municipality in which the farmland is located. The minimum credit is 10% of excessive property tax.
- The farmland tax relief credit equal to a percentage, determined by the Department of Revenue, of the first \$10,000 of property taxes on farmland exclusive of improvements. The Department of Revenue annually determines the credit percentage so that expenditures on the credit for all claimants is \$15 million, adjusted for expenditures in excess of, or less than, this amount in the prior fiscal year. The 2003 credit equaled 16% of property taxes, but not more than \$1,500; the credit averaged \$422.

In addition to this regular tax, Wisconsin imposes an alternative minimum tax that may limit the benefit of some tax exemption devices. The alternative minimum tax is equal to 6.5% of alternative minimum taxable income above the applicable exemption amount (\$35,750 if single, \$49,000 if married filing a joint return and \$24,500 if married filing a separate return).

### Estimates of Fiscal Effects

Estimates of individual income tax exemption devices are provided in Table 3. Descriptions of each device follow the table. The table identifies the exemption devices, indicates the statutory section allowing the exemption device and provides an estimate of its fiscal effect in FY04.

Several approaches were used to generate the estimates shown in Table 3. The estimates of exclusions from gross income, which are not reported on tax returns, were generally based on estimates of the fiscal effect of federal tax expenditures – i.e., federal tax exemption devices – contained in the annual budget document issued by the Executive Office of the President. Estimates prepared by the Congressional Budget Office and the staff of the Joint Committee on Taxation were also considered. Generally, Wisconsin's share of the federal fiscal effect was determined using the state's share of total federal adjusted gross income on all federal tax returns, and then adjustments were made to account for the differences in federal and Wisconsin tax rates.

Most of the other estimates were based on Wisconsin-specific data sources, including the 2003 Wisconsin individual income tax model, aggregate statistics from the 2003 tax processing year, and tax collection statistics for FY04. The tax model is derived from a scientifically stratified sample of approximately 20,000 tax returns, weighted to reflect the statewide population of tax filers in 2003. This model was used to simulate the effect of tax exemption devices for which data is captured in the sample. The aggregate statistics were drawn from tax returns processed from July 1, 2003 to June 30, 2004.

**TABLE 3**  
**INDIVIDUAL INCOME TAX EXEMPTION DEVICES SUMMARY**

Exemption Device	Statutory Reference*	FY04 Fiscal Effect
<b>Exclusions from Gross Income</b>		
Gain from Sale or Exchange of Residence (Home)	IRC 121	\$132,000,000
Social Security Benefits	IRC 86	162,000,000
Railroad Retirement Annuities and Pensions	IRC 86	1,250,000
Public Assistance	IRC 61	2,300,000
Sickness and Injury Benefits	IRC 104 to 106	731,000,000
Group Term Life Insurance Purchased for Employees	IRC 79	11,600,000
Death Benefits	IRC 101	51,500,000
Meals and Lodging to Employees	IRC 119	7,300,000
Scholarships and Fellowships	IRC 117	8,000,000
Awards and Prizes	IRC 74 (b) and (c)	Minimal
Payments to Victims of Nazi Persecution	IRC 61 (P.L. 107-16, Section 803)	Minimal
Rental Value of Parsonages	IRC 107	2,500,000
Reduced Armed Forces Retirement Pay	IRC 122	Not available
Combat Pay and Other Armed Forces Exclusions	IRC 112 and 134	37,000,000
Life Insurance Dividends	IRC 7702	30,000,000
Cancellation of Business Property Indebtedness	IRC 108 (a)	Minimal
Income Realized from Debt Cancellation Through Bankruptcy	IRC 108	Not available
Interest on Certain State and Local Bonds	ss. 66.1201 (14)a, 66.1333 (5)(a)4.c and 71.05 (1)(c)	Not available
Gifts and Inheritances	IRC 102	Not available
Appreciation of Property Held at the Time of Death	IRC 1014	41,000,000
Employer Contributions to Pension Plans and Net Pension Fund Earnings	IRC 401 to 404A, 406 to 407 and 409 to 417	731,000,000
Employer Reimbursement of Employee's Educational Expenses	IRC 127	3,300,000
Employer-Provided Child Care	IRC 129	4,000,000
Employer-Provided Adoption Assistance	IRC 137	500,000
Roth Individual Retirement Accounts	IRC 408A	114,000,000
Education Individual Retirement Accounts	IRC 530	650,000
Transportation and Other Fringe Benefits	IRC 132 (a)	16,400,000
Foster Care Payments	IRC 131	1,400,000
Cancellation of Student Loans	IRC 108 (f)	Minimal
Recovery of Tax Benefit Items	IRC 111	Minimal
Foreign Earned Income	IRC 911	17,000,000
Natural Resource-Related Cost-Sharing Payments	IRC 126	Minimal
Passive Activity Losses	IRC 469	8,300,000
<b>Adjustments to Gross Income</b>		
Capital Losses	IRC 1211; s. 71.05 (10)(c)	6,800,000
Losses from the Sale or Exchange of Business Property	IRC 62 (a)(3)	3,800,000
Pension, Profit-Sharing, Annuity and Bond Purchase Plans of Self-Employed Individuals	IRC 62 (a)(6)	13,800,000
Traditional Individual Retirement Accounts	IRC 62 (a)(7), 219 and 408	12,600,000
Deduction for Higher Education Expenses	IRC 222	None
Student Loan Interest	IRC 221	6,300,000
Qualified State Tuition Programs	IRC 529	800,000
Self-Employment Tax	IRC 164 (f)	16,200,000
Health Insurance of Self-Employed Persons	IRC 162 (l)	17,000,000
Medical Savings Accounts and Health Savings Accounts	IRC 220 and 223	Not available
Moving Expenses	IRC 217	1,100,000
Alimony	IRC 62 (a)(10), 71 and 215	10,000,000
Penalty on Early Withdrawal of Savings	IRC 62 (a)(9)	125,000

\* References to sections of the 2003 Wisconsin Statutes, except "IRC" indicate a reference to a section of the federal Internal Revenue Code authorizing the exemption device.

**TABLE 3**  
**INDIVIDUAL INCOME TAX EXEMPTION DEVICES SUMMARY, (continued)**

Exemption Devices	Statutory Reference*	FY04 Fiscal Effect
<b>Modifications to Federal Adjusted Gross Income</b>		
Social Security Benefits: Difference in State and Federal Treatment	s. 71.05 (6)(b)21	40,000,000
Interest on U.S. Obligations	s. 71.05 (6)(b)1	12,000,000
Capital Gains Deduction	s. 71.05 (6)(b)9	156,000,000
Capital Gains from Qualified Small Business Stock	s. 71.05 (6)(b)6	Not available
Gains on Sales of Business Assets to Related Persons	s. 71.05 (6)(b)25	140,000
Net Long-Term Capital Losses (Pre-1982)	s. 71.05 (14)	Minimal
Public Pensions	s. 71.05 (1)(a), (am) and (an)	51,500,000
State Legislators' Per Diem Expenses	s. 71.05 (1)(b)	81,000
Small Business (Subchapter S) Corporation Subtractions	s. 71.05 (10)(b)	Not available
Distributive Share of Estates and Trusts	s. 71.16 (1)	Not applicable
Distributive Share of Partnership Modifications	s. 71.05 (9)	Not applicable
Wisconsin Net Operating Loss Carryover	s. 71.05 (8)	2,700,000
Health Insurance Premiums of the Self-Employed and Certain Employees: Difference in State and Federal Treatment	s. 71.05 (6)(b)19 and 20	1,800,000
Long-Term Care Insurance Expenses	s. 71.05 (6)(b)26	3,100,000
Constant Basis Assets	s. 71.05 (13)(b)	Minimal
Adjusted Basis of Assets Acquired after January 1, 1965	s. 71.05 (19) and (20)	Minimal
Unemployment Compensation	s. 71.05 (6)(b)8	5,800,000
Disability Income	s. 71.05 (6)(b)4	Minimal
Adoption Expenses	s. 71.05 (6)(b)22	Minimal
Higher Education Tuition Expenses	s. 71.05 (6)(b)28	16,000,000
Prepaid Tuition and College Savings Plans	s. 71.05 (6)(b)23 and 31 to 33	5,800,000
Viatical Settlement Contracts	s. 71.05 (1)(f)	Minimal
Payments to Victims of Nazi Persecution	s. 71.05 (6)(b)30	Minimal
Human Organ Donation Expenses	s. 71.05 (10)(i)	None
Active Duty Military Pay	s. 71.05 (6)(b)34	None
<b>Deductions and Exemptions from Wisconsin Adjusted Gross Income</b>		
Standard Deduction	s. 71.05 (22)	534,000,000
Personal Exemption and Additional Elderly Exemption	s. 71.05 (23)	185,000,000
<b>Credits</b>		
Itemized Deductions Credit	s. 71.07 (5)	275,000,000
School Property Tax Credit	s. 71.07 (9)	362,000,000
Working Families Credit	s. 71.07 (5m)	572,000
Married Couple Credit	s. 71.07 (6)	269,000,000
Armed Forces Member Credit	s. 71.07 (6m)	914,000
Credit for Sales Tax on Fuel and Electricity Used in Manufacturing	s. 71.07 (3s)	11,800,000
Development Zone Credits	s. 71.07 (2dm) and (2dx)	2,100,000
Angel Investment Credit and Early Stage Seed Investment Credit	s. 71.07 (5b) (and (5d)	None
Historic Preservation Credits	s. 71.07 (9m) and (9r)	1,377,000
Earned Income Credit	s. 71.07 (9e)	73,000,000
Homestead Credit	ss. 71.07 (4), 71.51 to 71.55	120,000,000
Income Taxes Paid to Other States/Income Tax Reciprocity	ss. 71.07 (7), 71.10 (7) and (7e)	160,000,000
Claim of Right Credit	s. 71.07 (1)	Minimal
Farmland Tax Relief Credit	s. 71.07 (3m)	12,700,000
Farmland Preservation Credit	ss. 71.07 (3) and 71.57 to 71.61	14,200,000
<b>Deductions Which Further Define Net Income</b>		
Trade and Business Expenses	IRC 62 (a)(1)	Not applicable
Employee's Trade and Business Expenses	IRC 62 (a)(2)	Not applicable
Expenses Related to Rent and Royalty Income	IRC 62 (a)(4)	Not applicable

\* References to sections of the 2003 Wisconsin Statutes, except "IRC" indicate a reference to a section of the federal Internal Revenue Code authorizing the exemption device.

## EXCLUSIONS FROM GROSS INCOME

An exclusion is a type of income that is not included in federal gross income by provisions of the Internal Revenue Code or under the U.S. Constitution, or in Wisconsin income by provisions of the Wisconsin Statutes. Excluded income does not have to be reported on the income tax return.

### Gain from Sale or Exchange of Residence (Home)

A taxpayer may exclude from income up to \$250,000 (\$500,000 for married couples filing jointly) of capital gain realized on the sale or exchange of a residence. The taxpayer generally must have owned and occupied the home as a principal residence for at least two of the five years prior to the sale. An individual not meeting the ownership or residence requirements is allowed a pro rata amount of the exclusion if the sale or exchange is due to a change in employment, health, or other unforeseen circumstances. The exclusion is allowed on only one sale every two years, and it is not permitted on properties in which depreciation is allowed for rental or business use.

### Social Security Benefits

Old-age and survivors insurance benefit payments, state old-age assistance payments and Medicare benefits are generally excluded from the gross income of the person receiving such benefits. Federal law subjects up to 50% of benefits to tax when income exceeds a base amount and up to 85% of benefits when income exceeds an adjusted base amount. In this determination, income equals modified adjusted gross income plus one-half of social security.

The base amounts, for determining tax on up to 50% of benefits, are \$25,000 for single persons, including married persons filing separately who lived apart from their spouses for the full tax year; \$32,000 for married couples filing a joint return; or \$0 for married persons filing separately who lived with their spouses for at least part of the year. The adjusted base amounts, for taxing up to 85% of benefits, are \$34,000 for single persons, \$44,000 for married couples and \$0 for married persons filing separately and living with their spouses for at least part of the year.

Wisconsin partially follows the federal treatment, taxing up to 50% of social security benefits. The table provides separate fiscal estimates of the state revenue loss resulting from the federal exclusion and the loss resulting from the state modification to FAGI that limits the amount of social security benefits subject to tax to 50%, rather than 85%, of the total.

### Railroad Retirement Annuities and Pensions

Annuities or pensions paid under the 1935 and 1937 Railroad Retirement Acts are generally excluded from gross income. Up to 50% of Tier 1 retirement benefits are taxable for federal tax purposes, but the Railroad Retirement Acts specifically prohibit state taxation of retirement benefits, so Tier 1 benefits are completely excluded from gross income for state purposes.

### Public Assistance

Assistance provided under the Wisconsin Works program, Medicaid, general relief and other public assistance to individuals and families are excluded from the gross income of the recipients.

### Sickness and Injury Benefits

Compensation for sickness or personal injury excluded from gross income includes the following:

- Amounts received under the worker's compensation and social security acts,
- Damages received as a result of a court suit or other legal settlement in a personal injury case,
- Proceeds received from an accident, health or medical insurance policy paid for by the taxpayer,
- A pension, annuity or similar allowance for sickness or injury sustained while active in the armed forces, the Coast and Geodetic Survey, the Public Health Service or the Foreign Service, and disability income received by an employee of the United States for injuries incurred in a terrorist attack during the performance of duties outside the U.S.

- Employer contributions to an accident or health plan designed to benefit the employee, and
- Sick pay or employer-financed disability benefits, other than reimbursement for medical expenses deducted in the same year or a prior year, which is regarded as taxable income.

### **Group Term Life Insurance Purchased for Employees**

The cost of group term life insurance provided to an individual under a policy carried by an employer is generally considered taxable income. However, the cost incurred in purchasing the first \$50,000 worth of coverage is excluded from the gross income of employees.

### **Death Benefits**

Two types of payments made to survivors of a deceased individual are excluded from gross income. First, amounts paid under a life insurance contract are excluded whether these sums are paid at one point or over time. Second, up to \$5,000 of death benefits paid by an employer to a beneficiary are similarly disregarded for tax purposes.

### **Meals and Lodging to Employees**

Employees may exclude from gross income the value of any meals or lodging provided to them for the convenience of the employer. Meals must be furnished on the employer's business premises and lodging must have been accepted by an employee as a condition of employment.

### **Scholarships and Fellowships**

Scholarships and fellowships are excluded from gross income when received by a degree candidate at an educational institution and when used to pay tuition and course-related fees or to purchase books, equipment and supplies. Amounts used for room and board, however, must be included in income. Scholarships and fellowships do not qualify for the exclusion if they are made either to compensate the recipient for services provided, or to allow the recipient to pursue studies or research that primarily benefit the person or institution paying the scholarship and fellowship.

### **Awards and Prizes**

Awards or prizes received in recognition of religious, charitable, scientific, educational, literary or civic achievement may be excluded from gross income if the amount received is transferred to a government agency or a charitable organization. Further, the exclusion applies only if the recipient was selected without any action on his or her part to enter the competition for the award and only if the recipient is not required to render any substantial future services as a condition of receiving the award.

Employee awards for length of service or achievement are generally excludable from gross income to the extent of the deduction claimed by the employer. Deductions of such awards are limited.

### **Payments to Victims of Nazi Persecution**

Restitution payments received by persons persecuted by Nazi Germany or countries allied to it or received by their heirs or estates are excluded from gross income.

### **Rental Value of Parsonages**

The allowance paid to a minister for the purpose of renting a home, or the rental value of the home furnished as part of compensation, is excluded from gross income. In both cases, the associated utility expenses are considered part of the allowance and, as such, excluded from gross income.

### **Reduced Armed Forces Retirement Pay**

The amount deducted from retirement or retainer pay of members or former members of the United States Armed Forces under the Retired Serviceman's Family Protection Plan is excluded from gross income. The reduction in retirement pay is made by contract between the member of the service and the Armed Forces for the purchase of an annuity. This reduction is between 12.5% and 50% of retirement pay, but in no case less than \$25. If the

person should die before the amount of the contract is paid, the survivor receiving the annuity may exclude from gross income any reductions in annuity payments used to conclude the contract.

### **Combat Pay and Other Armed Forces Exclusions**

The monthly compensation of members of the United States Armed Forces is excluded from gross income if the taxpayer served in a combat zone. The exclusion for commissioned officers is limited to the maximum amount that enlisted personnel may exclude. Currently designated combat zones and hazardous duty areas include:

- Afghanistan, along with Uzbekistan, Kyrgyzstan, Pakistan, Tajikistan, and Jordan;
- The Federal Republic of Yugoslavia (Serbia/Montenegro), Albania, the Adriatic Sea, and the Ionian Sea north of the 39th parallel;
- Bosnia, Herzegovina, Croatia, and Macedonia;
- The Persian Gulf, the Red Sea, the Gulf of Oman, the part of the Arabian Sea that is north of 10 degrees north latitude and west of 68 degrees east longitude, the Gulf of Aden, and the total land areas of Iraq, Kuwait, Saudi Arabia, Oman, Bahrain, Qatar, and the United Arab Emirates;
- The Philippines (only troops with orders referencing Operation Enduring Freedom);
- Yemen and Djibouti; and
- Turkey, Israel, Egypt and the Mediterranean Sea east of 30 degrees East longitude.

Exclusions applicable to miscellaneous Armed Forces income are:

- All payments of benefits under any law administered by the Veterans' Administration (38 U. S. Code 3101);
- A pension of \$100 per month for all persons over the age 65 who are on the Army, Navy, Air Force, or Coast Guard Medal of Honor roll (38 U. S. Code 562);
- Benefits under World War Adjusted Compensation Act;
- Benefits under World War Veteran's Act;
- Leave compensation payment under Armed Forces Leave Act;
- G.I. Bill educational benefits;
- In-kind benefits provided to armed forces personnel;

### **Life Insurance Dividends**

Dividends on matured insurance policies may be excluded from gross income for income tax purposes.

### **Cancellation of Business Property Indebtedness**

A taxpayer need not recognize income when a debt of the taxpayer is fully or partially canceled if the individual incurred the debt in connection with property used in a trade or business. The taxpayer must agree to reduce the basis (cost) of the property if an economic benefit was realized as a result of the discharge of a debt for the purpose of determining future depreciation and capital gains or losses.

### **Income Realized from Debt Cancellation Through Bankruptcy**

When a debt is forgiven in connection with a bankruptcy proceeding, the income realized is not subject to tax unless the principal purpose of the bankruptcy plan is the evasion of income taxes.

### Interest on Certain State and Local Bonds

In general, interest on obligations of state and local governments is subject to the Wisconsin income tax, even though such income may be exempt from federal taxation. However, interest on the following bonds is exempt:

- bonds issued by city housing authorities, city redevelopment authorities, local exposition districts and local cultural arts districts;
- bonds issued by the Wisconsin Housing and Economic Development Authority (WHEDA) before January 29, 1987 (except business development, economic development, and housing revenue bonds);
- Wisconsin professional baseball park and football stadium district bonds;
- Wisconsin Housing Finance Authority (WHFA) bonds (that is, bonds issued before 1983, when WHFA became known as WHEDA); and
- Wisconsin higher education bonds.

### Gifts and Inheritances

The value of property received by gift, inheritance, devise or bequest is excluded from gross income. This exclusion does not apply to the income from property received by gift or bequest nor to a gift or bequest consisting of income from property rather than the property itself.

No data are available on the total value of property transferred by gift or inheritance, so no estimate of the revenue loss can be made. Property transferred at death, for deaths occurring after September 30, 2002, is subject to the Wisconsin estate tax when the value of the estate exceeds \$675,000. Only about 2% of all estates are subject to this tax; however, they account for a substantially larger share of the total value of property transferred at death, since they are the very largest estates. The fiscal effect in FY04 of the income tax exclusion for these largest estates was approximately \$100 million. Wisconsin estate taxes paid by these estates during FY04 were \$83 million.

### Appreciation of Property Held at the Time of Death

Appreciation (gain) from property held at the time of death is not subject to tax for either the deceased or his or her heirs. The basis of inherited property generally is its fair market value at the time of the decedent's death, rather than its cost when the decedent acquired it. As a result, the appreciation of the property while it was held by the decedent – the difference in fair market value at the time of death and the decedent's cost of purchasing the property – is not taxed.

With the repeal of the federal estate tax in 2010, this exclusion will be eliminated in that year. The basis of the property for the heir will be the decedent's basis of the property, so the appreciation of the property while it was owned by the decedent will be taxable income for the heir when he or she sells the property. Under current federal law, the repeal of the federal estate tax and the change in basis rules for property transferred at death are sunsetted after 2010—the estate tax and the current basis rules will be reinstated, barring further changes in federal law.

The estimate of the revenue loss from this exclusion reflects the effect of Wisconsin's 60% exclusion for long-term capital gains.

### Employer Contributions to Pension Plans and Net Pension Fund Earnings

Amounts contributed to qualified pension, profit-sharing, stock bonus, bond purchase and annuity plans by an employer on behalf of his or her employees are generally not treated as income taxable to the employees at the time the contributions are made. Further, employers may generally deduct these contributions from gross income, and the earnings that accrue on the contributions are excluded from the employee's income, so long as the assets are retained within a qualified plan.

Tax is imposed when distributions are made from the plan to employees in the form of pensions and annuities. At that time the taxable portion of the plan benefits must be included in the gross income of the recipient. The portion of the benefits representing the employee's contribution to the plan is not taxable upon distribution if the employee's contributions were already included in income and subject to tax at the time the contributions were made.

Taxing employer contributions and earnings on pension plan assets at the time of withdrawal, rather than at the time of contribution, results in a revenue loss if the plan beneficiary pays tax at a lower rate when retired than when working.

### **Employer Reimbursement of Employee's Educational Expenses**

Up to \$5,250 of non-job related employer-provided educational assistance may be excluded from gross income.

### **Employer-Provided Child Care**

The value of child or dependent care services provided by an employer under a nondiscriminatory plan is excluded from gross income to the extent that the amount excluded does not exceed \$5,000 (\$2,500 for married separate filers). Further, the value of services excluded may not exceed the earned income of the employee or the earned income of an employee's lower-earning spouse.

### **Employer-Provided Adoption Assistance**

Up to \$10,000 per child in adoption assistance provided by an employer is excluded from gross income. The \$10,000 exclusion is allowed for special needs adoption even if that amount exceeds actual expenses incurred. The exclusion is phased out for persons with federal adjusted gross income between \$152,704 and \$192,704. The amount excludable and the phase out ranges are indexed for inflation.

### **Roth Individual Retirement Accounts**

A Roth IRA is an account for which the contributions are not deductible when made, but qualified distributions, including earnings on contributions, are not taxable. Persons whose adjusted gross income does not exceed \$95,000 if single, \$150,000 if married filing jointly or \$0 if married filing separately may contribute up to \$3,000 per person per year to a Roth IRA. The amount of contribution permitted is phased out as income rises to \$110,000 for single filers, \$160,000 for married joint filers and \$10,000 for married separate filers.

The increases in contribution limits and the catch-up contributions for taxpayers age 50 and older that apply to traditional IRAs also apply to Roth IRAs.

Distributions from a Roth IRA are not subject to tax if they are made no earlier than five years after the account is established and if the taxpayer has reached age 59½. Earlier distributions are not subject to tax if they are made because of the death or disability of the taxpayer or for first-time homebuyer expenses (up to \$10,000). Nonqualified distributions must be included in gross income and are subject to a 10% penalty tax. Unlike a traditional IRA, distributions from a Roth IRA are not required upon reaching the age of 70½.

### **Education Individual Retirement Accounts**

An education IRA is similar to a Roth IRA: contributions are not deductible, but qualified distributions are not subject to tax if they are used to pay the post-secondary expenditures of the beneficiary.

For tax year 2003, contributions of up to \$2,000 per child may be made to an education IRA when income is less than \$95,000 for single persons and \$190,000 for married couples filing jointly. The amount that may be deducted is phased out as income rises to \$110,000 for single filers and \$220,000 for married joint filers.

### **Transportation and Other Fringe Benefits**

Employer-provided transportation in a commuter vehicle, transit passes and parking are excluded from income of the employee receiving these benefits. In 2003, the exclusion for commuter transportation or transit passes is limited to \$100 per month and the exclusion for parking is limited to \$190 per month. These amounts are indexed for inflation.

Other fringe benefits excluded from income includes services provided by employers to employees at no additional cost to the employer, employee discounts, property or services for which an employee would be allowed a deduction if the employee provided that property or service, property or service of minimal value, reimbursement of moving expenses, and retirement planning services. Only the transportation benefits have a measurable fiscal effect.

**Foster Care Payments**

Foster care payments to care providers by a state or local government or a foster care placement agency are excluded from income.

**Cancellation of Student Loans**

The amount of a student loan funded by federal, state or local government programs that has been forgiven is not included in taxable income when the cancellation is contingent upon the beneficiary working for a specified period of time in a certain area or for a particular type of employer.

**Recovery of Tax Benefit Items**

Income from the recovery of an amount for which a tax deduction or other benefit was claimed during the previous year is not included in income if the deduction did not reduce income tax liability in that previous year. However, if the deduction led to reduced tax liability in a prior year, then the recovery is taxable. An example of a recovered tax benefit item is a debt that is written off in one year but received in a later year.

**Foreign Earned Income**

Qualified individuals who work abroad and receive earned income from foreign sources may elect to exclude up to \$80,000 of such income in 2003 and thereafter. The exclusion amount is adjusted to take into account employer-provided housing allowances, or housing expenses, where allowances are not provided, and the maximum exclusion is reduced for taxpayers who work abroad for only part of a year.

**Natural Resource-Related Cost-Sharing Payments**

Payments received by individuals primarily for the purpose of conserving soil and water resources, protecting or restoring the environment, improving forests, or providing a habitat for wildlife, may be excluded from gross income.

**Passive Activity Losses**

In general, when the deductions exceed the income from a business activity, the resulting loss can be offset against other types of income. However, passive activity losses – those from business activities in whose management or operation taxpayers do not actively or materially participate – are subject to passive loss restrictions. Under the restrictions, passive losses can only be offset against other passive income. Passive losses subject to the restrictions are suspended and carried forward indefinitely until used against other passive income or until the taxpayer disposes of the ownership interest in the passive business activity in a fully taxable transaction.

Certain activities are explicitly treated by the tax code as either passive or active. For example, interest, dividends, annuities, royalties and other portfolio income are not treated as income from a passive activity, so net losses generated from passive activities cannot be used to offset portfolio income.

A rental activity generally is treated as a passive activity, though a limited exception exists for rental activity losses incurred by a taxpayer who actively participates in the rental real estate venture and owns at least a 10% interest in the rental property. Under the exception, up to \$25,000 of losses from rental real estate may be used to offset income from nonpassive sources. The \$25,000 maximum is reduced (but not below zero) when the taxpayer's adjusted gross income exceeds \$100,000, and is completely phased out when AGI exceeds \$150,000. Special rules apply for married taxpayers who file separate returns and live apart. A taxpayer with a working interest in oil and gas activities is also exempt from the passive loss rules.

**ADJUSTMENTS TO GROSS INCOME**

An adjustment is an amount subtracted from gross income to arrive at adjusted gross income.

**Capital Losses**

Losses from the sale or exchange of capital assets may be used to offset gains from capital assets. If the amount of capital losses exceeds the amount of capital gains in the current year, the net capital loss may be used to offset up to \$500 of ordinary income for Wisconsin tax purposes (under federal law, the offset is limited to

\$3,000). The amount of net capital loss not allowed as a deduction in the current year may be carried forward to future years offset capital gains or ordinary income up to the \$500 limit, up to 15 years.

Wisconsin treatment of long-term losses incurred prior to tax year 1982 also differs from the federal treatment. The Wisconsin modification for these pre-1982 long-term losses is described in the section on "Modifications to Federal Adjusted Gross Income."

### **Losses from the Sale or Exchange of Business Property**

Losses from the sale or exchange of property used in a business are deductible.

### **Pension, Profit-Sharing, Annuity, and Bond Purchase Plans of Self-Employed Individuals**

A self-employed taxpayer may deduct from gross income contributions made on the taxpayer's behalf to a pension, profit-sharing, annuity, or bond purchase plan. Contributions must be made from earned income.

### **Traditional Individual Retirement Accounts**

Persons contributing to a traditional individual retirement account (IRA) may claim a deduction for the amount contributed and are not taxed on the earnings that remain in a traditional IRA. IRA contributions and earnings on them are taxable when withdrawals are made from the account.

The deduction for contributions is limited to persons who are not covered by an employer-provided retirement plan or who are covered by such plans but has adjusted gross income, for tax year 2003, less than \$40,000 for single persons, \$60,000 for married persons filing jointly or \$0 for married persons filing separately. These income floors are being increased each tax year through 2007. The deduction is phased out over the next \$10,000 of income.

For tax year 2003, the deduction is generally limited to \$3,000 for each tax filer and spouse, but not more than the person's earnings. For married couples, the combined IRA deduction may not exceed combined earnings; in other words, a spouse with little or no earnings may still claim an IRA deduction if the other spouse has earnings in excess of his or her own IRA deduction. These maximum contributions are coordinated among the three types of IRAs; the combined contribution to all IRAs for any one person cannot exceed \$3,000 or the person's earnings. The maximum contribution is being increased, beginning in 2005, and will eventually be \$5,000 in 2008 and thereafter. Further, taxpayers age 50 and older are allowed additional "catch-up" contributions of \$500 per year in 2002-2005 and \$1,000 in subsequent years.

With limited exceptions, amounts in a traditional IRA cannot be withdrawn without penalty prior to age 59½. Early withdrawals must be included in gross income and are also subject to an additional 10% penalty tax. The 10% early withdrawal penalty does not apply in cases of death and disability or when the withdrawals are used for qualified higher education expenses or first-time homeowner expenses (up to \$10,000). Amounts withdrawn from an IRA after age 59½ must be included in gross income in the year of the withdrawal. Withdrawals must begin after the individual reaches the age of 70½. Insufficient withdrawals after age 70½ are subject to a penalty tax.

Persons can make nondeductible contributions to their retirement accounts and the earnings on those nondeductible contributions can be excluded from income, as long as the assets are retained within the retirement account.

### **Deduction for Higher Education Expenses**

For 2002 and 2003, a deduction of up to \$3,000 was allowed for higher education expenses when income does not exceed \$65,000 for single persons and \$130,000 for married couples filing jointly. In 2004 and 2005, the maximum deduction will be increased to \$4,000, and a \$2,000 deduction will be allowed for single persons whose income is between \$65,000 and \$80,000 and married couples whose income is between \$130,000 and \$160,000. The deduction is eliminated after 2005.

Wisconsin did not adopt this deduction, since it provides its own tuition deduction, described in the "Modifications to Federal Adjusted Gross Income" section.

### **Student Loan Interest**

Persons who have taken out loans on behalf of themselves, their spouse or their dependents to pay for the cost of attending an eligible educational institution may deduct the interest they pay on these loans. The maximum deduction allowed is \$2,500. For 2003, the maximum deduction amount is reduced for single and head of household filers when FAGI is more than \$50,000 and is eliminated when FAGI exceeds \$65,000; for married joint filers the deduction is phased out between \$100,000 and \$130,000 of FAGI. The \$50,000 and \$100,000 amounts are indexed for inflation. Married separate filers and those filers claimed as dependents on another's return may not claim the deduction.

### **Qualified State Tuition Programs**

Distributions from qualified tuition programs, whether these plans are state-sponsored or offered by private institutions, are exempt from federal tax. Under these programs, contributors purchase tuition credits or certificates on behalf of a designated beneficiary, entitling the beneficiary to a waiver of payment of qualified higher education expenses. Prior to 2002, earnings on these contributions were deferred until distributed and then taxable to the beneficiary, rather than the contributor. Wisconsin provides its own exemption for earnings on prepaid tuition and college saving plans, as well as contributions to these plans, described in the "Modifications to Federal Adjusted Gross Income" section. The fiscal effect for this exemption device reflects Wisconsin's adoption of the federal exemption for distributions.

### **Self-Employment Tax**

Self-employed persons are allowed to deduct one-half of their self-employment taxes, which are paid for social security and Medicare coverage. This deduction equalizes treatment between self-employed and employed persons. For the employed, the social security tax is shared equally by the employer and the employee; the amount paid by the employer is not considered income to the employee and is deductible for the employer.

### **Health Insurance of Self-Employed Persons**

Under federal law, self-employed persons can deduct up to 100% of premiums paid for health insurance. The deduction may not exceed the earned income from the trade or business for which the insurance plan was established. Wisconsin has its own deduction for up to 100% of the premiums paid for health insurance by self-employed persons, which was put in place when only a partial deduction was allowed under federal law.

### **Medical Savings Accounts and Health Savings Accounts**

The federal deduction allowed for contributions to an Archer Medical Savings Account (MSA) by participants in the MSA pilot program is also allowed for Wisconsin tax filers. Participation in an MSA is limited to the self-employed or to persons employed by firms with 50 or fewer employees. Participation also requires concurrent enrollment in a high deductible health plan, defined as a health plan with a higher annual deductible than typical health plans and with a maximum limit on the annual amount of out-of-pocket medical expenses that the participant must pay for covered expenses. For 2003, the limits for annual deductibles range from \$1,700 to \$2,550 for individual coverage and from \$3,350 to \$5,050 for family coverage; out-of-pocket expenses are limited to \$3,350 for individuals and \$6,150 for families. These amounts are adjusted for inflation each year.

Under the MSA pilot, employer's contributions are excluded from gross income and contributions by individuals are deductible from income. Contributions are limited to 65% of the health insurance deductible for individual plans and 75% of the deductible for family coverage. Distributions from an MSA are excluded from income if used to pay qualified medical expenses, including unreimbursed medical costs of an eligible MSA participant, and his or her spouse or dependents. MSA distributions may not be used to purchase insurance, except for COBRA-type continuation coverage or long-term health insurance. Distributions used for nonqualified expenses are subject to a 15% penalty, unless the participant is disabled or is age 65 or older.

Beginning in 2004, MSAs will be discontinued and replaced with health savings accounts (HSA), which were created under the Medicare Modernization Act of 2003. Funds from an existing MSA can be rolled over into a new HSA tax free. Wisconsin tax law does not recognize the federal provision on HSAs.

Contributions to an HSA may be deducted from federal gross income. The maximum deduction is limited to \$2,600 for self-only coverage and \$5,150 for family coverage. These amounts are annually indexed for inflation.

If the individual has attained age 55 by the end of the taxable year the limitation amount is increased by \$500 in 2004, \$600 in 2005, \$700 in 2006, \$800 in 2007, \$900 in 2008 and \$1,000 for 2009 and thereafter.

The amount of the allowable deduction is reduced by the amount paid to Archer MSAs for the individual during the taxable year. Amounts contributed to an individual's HSA by his or her employer are not deductible because they are already excluded from the individual's gross income. Employers contributing to the HSA of their employees must make comparable contributions to the HSA of each employee or pay a tax equal to 35% of the amount contributed by the employer to the HSAs of employees for the relevant taxable year.

Individuals are eligible for the deduction if they are covered under a high deductible health plan and if the individual is not simultaneously covered under a health plan which is not a high deductible health plan or which provides coverage for any benefit that is covered under the high deductible health plan. A high deductible health plan must have an annual deductible of at least \$1,000 for self-only coverage and \$2,000 for family coverage. The sum of the annual deductible and other annual out-of-pocket expenses required to be paid under the plan for covered benefits may not exceed \$5,000 for self-only coverage and \$10,000 for family coverage.

HSA distributions may not be used to purchase health insurance. Any HSA distributions not used to pay the qualified medical expenses of the account beneficiary are included in federal gross income. The individual must also pay a penalty in the amount of 10% of the distributions not used to pay qualified medical expenses, which would be included in federal gross income. There would be no penalty if the distributions were made after the account beneficiary becomes disabled or dies.

Any distributions from an HSA to pay the qualified medical expenses of the account beneficiary may not be treated as qualified medical expenses for the purpose of itemized deductions.

### **Moving Expenses**

A deduction from gross income is allowed for moving expenses when the move is related to starting work in a new location. Deductible moving expenses include the cost of transporting household goods and personal effects, and the cost of travel to the new residence, including lodging, but not meals.

### **Alimony**

Alimony, separate maintenance or similar periodic payments may be deducted from the gross income of the spouse or former spouse making the payments; however, they are deductible only to the extent that the payments are includible in the gross income of the recipient. Such payments must be made pursuant to a decree of divorce or separation. Child support and property settlements are not considered alimony.

### **Penalty on Early Withdrawal of Savings**

Penalties paid because of premature withdrawal of funds from time savings accounts or deposits may be deducted from gross income. The adjustment is allowed for amounts forfeited to a bank, mutual savings bank, savings and loan association, cooperative bank or homestead association as a penalty for premature withdrawal of funds from a time savings account, certificate of deposit or similar class of deposit. The deduction is not allowed when the loss is incurred in a transaction connected with a trade or business.

## **MODIFICATIONS TO FEDERAL ADJUSTED GROSS INCOME**

A modification is an addition to or subtraction from federal adjusted gross income authorized by the Wisconsin Statutes to compute Wisconsin adjusted gross income (also referred to as Wisconsin total income). In this report, with the exception of the capital gains add modification discussed in the previous section on "Adjustments to Gross Income," only subtraction modifications are described because only they constitute tax exemption devices.

### **Social Security Benefits: Difference in State and Federal Treatment**

Wisconsin taxes up to 50% of social security benefits, while up to 85% of those benefits are subject to federal tax. A subtract modification allows taxpayers subject to the higher federal taxation to reduce taxable social security to the amount taxable in Wisconsin. The \$39.4 million revenue loss for this modification is in addition to the \$147 million revenue loss from the exclusion discussed in the "Exclusions from Gross Income" section; the total fiscal effect of the state's tax treatment of social security is \$186.4 million.

**Interest on U.S. Obligations**

All interest and dividend income, less related expenses, received on obligations of the United States, its territories and the District of Columbia may be subtracted from federal adjusted gross income in determining Wisconsin adjusted gross income. The subtraction applies to interest on obligations issued directly by the federal government and obligations issued by independent agencies, which federal law prohibits states from taxing.

The state taxes interest and dividend income, less related expenses, received from obligations issued by independent agencies that are merely guaranteed by the federal government, provided federal law does not prohibit state taxation. These include bonds issued by the Federal National Mortgage Association, Government National Mortgage Association and the Tennessee Valley Authority. The fiscal effect of this exemption is difficult to estimate because a significant portion of these bonds are held indirectly by individuals through mutual funds, partnerships and other investment vehicles.

**Capital Gains Deduction**

Wisconsin allows taxpayers to exclude from income 60% of the capital gain on assets held more than one year.

**Capital Gains from Qualified Small Business Stock**

The state excludes from income 100% of the amount of net capital gains from qualified business stock issued on or after January 1, 1986. To qualify for the exclusion, taxpayers must be issued a certification notice by the business, have not acquired the stock as a gift, and hold the stock for a period of at least five years. The criteria for qualified small businesses are listed under sec. 71.01 (10), Wis. Stats. In general, only initial public offerings of small Wisconsin businesses qualify for the exclusion.

**Gains on Sales of Business Assets to Related Persons**

Gains on sales of business assets, including assets used in farming, to persons related to the seller within the third degree of kinship are not subject to tax. These related persons include parents, children, grandparents, grandchildren, brothers and sisters, uncles and aunts, nephews and nieces, and great grandchildren.

**Net Long-Term Capital Losses (Pre-1982)**

Net long-term capital losses from years prior to 1982 that were not allowed as an adjustment to federal gross income in the year a federal net capital loss deduction was taken may be subtracted from federal adjusted gross income. The subtraction is limited to \$3,000 (\$1,500 for married persons filing separately). The unused portion of pre-1982 net long-term capital losses may be carried forward to future years.

Taxpayers deducting pre-1982 net long-term capital losses are not subject to the \$500 state limit on the net capital loss deduction described in the earlier section on "Adjustments to Gross Income".

**Public Pensions**

Payments received from the selected retirement systems by persons who were members of or retired from these systems prior to 1964 are exempt from Wisconsin income, to the extent the payments were included in federal income. The Milwaukee Public School Teachers, Milwaukee City Employees, Milwaukee County Employees, Milwaukee County Sheriff, Milwaukee City Police, Milwaukee Fire Fighters and Wisconsin Public School Teachers retirement systems, and the U. S. Civil Service and Military Employee retirement system are covered by this exemption.

All payments from the U. S. military retirement system and all U. S. government pension payments received by retirees of the U. S. Coast Guard, the commissioned corps of the National Oceanic and Atmospheric Administration and the commissioned corps of the public health service are exempt.

**State Legislators' Per Diem Expenses**

Amounts received by state legislators as an allowance for expenses incurred while in Madison on legislative business are excluded from Wisconsin adjusted gross income, provided a deduction for travel expenses is not claimed.

### **Small Business (Subchapter S) Corporation Subtractions**

A subtraction modification may be allowed to reflect transitional adjustments or differences between the state and federal basis of stock in such corporations. Differences may exist because Wisconsin's treatment of S corporations differed from the federal treatment prior to 1979.

### **Distributive Share of Estates and Trusts**

The distributive share of income received from an estate or trust must be adjusted to reflect all Wisconsin modifications to federal adjusted gross income. The distributive share is the beneficiary's portion of income that is distributed from the estate or trust. An example is a taxpayer who receives a total of \$1,500 from a trust, \$300 of which is income derived from interest on U.S. securities. Since federal adjusted gross income includes such interest, the taxpayer subtracts this \$300 to arrive at Wisconsin adjusted gross income.

### **Distributive Share of Partnership Modifications**

The distributive share of income received from a partnership must be adjusted to reflect all Wisconsin modifications to federal taxable income. The distributive share is the taxpayer's portion of income from the partnership. An example is a partnership equally distributing \$2,000 in income to two partners, with \$1,000 of the income consisting of interest from U.S. Treasury bills. For federal purposes, each partner receives \$1,000 in taxable income. However, Wisconsin does not tax interest on U.S. Government securities, so each partner subtracts \$500 from federal income to arrive at Wisconsin adjusted gross income. This \$500 is the distributive share of the partnership modifications.

### **Wisconsin Net Operating Loss Carryover**

A net operating loss (NOL) is generally an excess of allowable business deductions over the gross income realized from operations. In determining whether a net operating loss exists, casualty losses are treated as business losses and salary or wages are treated as business income.

In Wisconsin, net operating losses may be carried forward up to 15 years to offset income, and thus reduce tax liability. Federal law allows taxpayers to carry losses back three years or forward 15 in determining taxable income of those years. This difference in federal and Wisconsin carryover periods and other differences in federal and state law may necessitate modifications to federal adjusted gross income to ensure that only Wisconsin business losses are carried forward for state tax purposes. For instance, state and local bond interest and federal NOL carrybacks may be added back to determine the deductible amount of the loss carried forward for Wisconsin purposes.

### **Health Insurance Premiums of the Self-Employed and Certain Employees: Difference in State and Federal Treatment**

Wisconsin allows the self-employed to deduct 100% of their premiums for health insurance for themselves, their spouses and dependents. This Wisconsin deduction has a limited impact because federal law also allows the self-employed to deduct 100% of their health insurance premiums and Wisconsin has adopted this federal law.

This deduction was enacted when federal law allowed only a portion of premiums to be deducted. Employees whose employer does not contribute towards the cost of their health insurance premiums may deduct 50% of their payments for health insurance. The deduction for the self-employed is limited to earned income derived from the trade or business for which the insurance plan was established. Persons eligible to participate in a health insurance plan sponsored by their own or their spouse's employer may not take the deduction. For employees, the deduction is limited to wages. Amounts deducted may not be claimed as medical expenses for purposes of calculating the itemized deductions credit.

The \$1.8 million revenue loss for this deduction relates almost exclusively to the deduction for employees whose employer does not contribute to their insurance coverage. The revenue loss to the state from the federal deduction for the self-employed is \$17.0 million, so the total fiscal effect of state health insurance deductions is \$18.8 million.

### **Long-Term Care Insurance Expenses**

A deduction is allowed for premiums paid for long-term care insurance. This insurance provides coverage for convalescent or custodial care, or care for a chronic condition or terminal illness that is provided in a person's home, an institution or a community-based setting. Qualified expenses include expenses for policies that cover a taxpayer and his or her spouse. Qualified expenses subtracted from gross income in the calculation of federal adjusted gross income cannot be claimed for this deduction. Also, qualified expenses claimed for this deduction cannot be used to calculate the Wisconsin itemized deduction credit.

### **Constant Basis Assets**

A taxpayer who sold or otherwise disposed of a constant basis asset that has a federal basis different from the Wisconsin basis is required to adjust Wisconsin income to reflect the amount of this difference. This provision applies if the asset was owned prior to January 1, 1965. A constant basis asset is one for which depreciation is not allowed, such as unimproved land.

### **Adjusted Basis of Assets Acquired after January 1, 1965**

A taxpayer who acquires a constant basis asset, such as unimproved land, that has a federal basis different from the Wisconsin basis is required to modify Wisconsin income to reflect the difference in the year that the asset is sold or otherwise disposed of. When a taxpayer acquires a changing basis asset, one for which depreciation is allowed, such as a building, Wisconsin income is modified to reflect differences in the state and federal bases each year, except that the differences may be amortized over a period of five years or less.

This section applies to property acquired after January 1, 1965, for Wisconsin tax purposes. It also generally applies to taxpayers who move into the state and bring certain property with them.

### **Unemployment Compensation**

Wisconsin excludes from income a portion of unemployment compensation when income falls below certain amounts. Taxable unemployment compensation equals the lesser of total unemployment compensation or 50% of the amount, if any, by which unemployment benefits plus the recipient's adjusted gross income (excluding unemployment compensation and certain disability benefits) exceed specified base amounts. The base amounts are: \$12,000 for single persons and married persons who file separately and lived apart from their spouses for the full tax year; \$18,000 for married persons filing a joint return; and \$0 for married persons who file separately but lived with their spouses for at least part of the tax year.

### **Disability Income**

A subtraction is allowed for payments to disabled persons that are included in federal income but were excluded under Section 105 (d) of the Internal Revenue Code prior to its repeal in 1983.

### **Adoption Expenses**

Adoptive parents may deduct adoption fees, court costs, or legal fees relating to the legal adoption of a child. This subtraction from federal adjusted gross income is limited to \$5,000 of adoption expenses that occur during the tax year in which the adoption is finalized and the two prior tax years. Employer-paid adoption expenses that under federal law are excluded from gross income may not be used for the deduction.

### **Higher Education Tuition Expenses**

A deduction of up to \$3,000 per student per year is allowed for tuition that is paid to any university, college, technical college or a school approved by the Educational Approval Board that is located in Wisconsin. Tuition paid to a public vocational school or public institution of higher education in Minnesota under the Minnesota-Wisconsin reciprocity agreement also qualifies for the deduction. Eligible expenses include tuition for the education of the claimant, the claimant's spouse, and his or her dependent. The maximum deduction amount is phased out in specified ranges of federal adjusted gross income: between \$50,000 and \$60,000 for single and head of household filers, \$80,000 and \$100,000 for married joint filers and \$40,000 and \$50,000 for married separate filers.

### **Prepaid Tuition and College Savings Plans**

A deduction of up to \$3,000 deduction per year is allowed for contributions to a college savings plan or to an existing prepaid tuition plan operated by EdVest. To prevent double-counting of the deduction, no deduction is allowed for any costs paid out using distributions from such a college savings or prepaid tuition plan. In particular, taxpayers cannot claim a deduction for tuition financed by a distribution from an EdVest account when the contribution that account was previously deducted.

The deduction is allowed when the beneficiary is the claimant, the claimant's child and dependent or the claimant's grandchild. Beginning in tax year 2004, the deduction is also allowed when the beneficiary is the claimant's great-grandchild, niece or nephew.

In addition, any interest earnings on contributions to an EdVest plan may be deducted, to the extent these earnings are included in federal adjusted gross income and provided that the distributions from the plan are used for qualified educational purposes. Distributions from these plans are exempt from federal tax. The fiscal effect for this exemption device reflects the revenue loss from Wisconsin's deduction for contributions and earnings in excess of any revenue loss from the federal exemption.

The prepaid tuition program is limited to University of Wisconsin System schools. The college savings plan allows individuals to purchase tuition units that apply toward tuition or other costs at any institution of higher education in the United States.

### **Viatical Settlement Contracts**

A viatical settlement is a payment to the holder of a life insurance policy, or to the certificate holder of a group life insurance certificate, which insures the life of a person who has a catastrophic or life-threatening illness or condition. The payment is less than the expected death benefit of the policy or certificate to the person making the payment. Income received under such a viatical settlement contract is exempt from the income tax.

### **Payments to Victims of Nazi Persecution**

Settlements or other payments of claims for assets stolen, hidden or lost by a person due to persecution by Nazi Germany or any Axis regime from 1933 to 1945 may be subtracted in the determination of Wisconsin adjusted gross income to the extent this income is included in federal income. Nonstatutory provisions of the federal Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) indicated that such payments were not included in federal gross income. As a result, this subtraction has no fiscal effect. The Holocaust Restitution Tax Fairness Act of 2002 repealed the sunset of the EGTRRA with respect to the exclusion from federal income tax for restitution received by victims of the Nazi Regime.

### **Human Organ Donation Expenses**

Beginning in tax year 2004, an individual who, while living, donates one or more of his or her human organs to another human being for human organ transplantation may subtract \$10,000 from federal adjusted gross income in the year in which the transplant occurs. The subtract modification may only be claimed for travel expenses, lodging expenses, and lost wages that are incurred by the claimant and related to his or her organ donation.

### **Active Duty Military Income**

Beginning in tax year 2004, members of the reserves or national guard components of the U.S. armed forces who are called to federal active duty may deduct from FAGI the amount of military pay received by these persons that relate to the period of time during which the person is on active duty. Military income received while on active duty and serving in a combat zone is already excluded from income and therefore may not be deducted from FAGI. Military pay deducted from income may not be used in claiming the armed forces member tax credit.

## **DEDUCTIONS AND EXEMPTIONS FROM WISCONSIN ADJUSTED GROSS INCOME**

A deduction is an amount subtracted from Wisconsin adjusted gross income (or total income) to yield Wisconsin taxable income – the amount to which the tax rates are applied. Federal taxpayers may claim either a standard deduction or an itemized deduction. Wisconsin taxpayers are allowed a standard deduction only, though taxpayers may be eligible for an itemized deductions credit, explained in the next section. Wisconsin also provides a personal exemption that is subtracted from Wisconsin adjusted gross income.

## Standard Deduction

Wisconsin provides a sliding scale standard deduction that decreases as income increases. For tax year 2003, the standard deduction for single persons was \$7,790 when Wisconsin adjusted gross income (WAGI) was less than \$11,220, and it was phased out as WAGI rose from \$11,220 to \$76,136. For heads of households, mostly single parents, the deduction was \$10,060 when WAGI was less than \$11,220, and it was phased down to the level of the standard deduction of single filers as WAGI rose from \$11,220 to \$32,808. When WAGI exceeded \$32,808, heads of households received the same deduction as single filers. For joint filers, the standard deduction was \$14,030 when WAGI was less than \$15,760 and was phased out when WAGI was between \$15,760 and \$86,697. For married persons filing separately, the standard deduction was \$6,660 when WAGI was less than \$7,480 and was phased out when WAGI was between \$7,480 and \$41,154. These amounts are indexed for inflation.

The estimate of revenue loss for the standard deduction does not reflect the amount of the itemized deductions credit that would be claimed by persons not currently claiming it if the standard deduction was eliminated; the credit cannot be calculated because the amount of their itemized deductions are not known.

## Personal Exemption and Additional Elderly Exemption

Wisconsin provides an exemption equal to \$700 for each tax filer, spouse and dependent, plus an additional exemption of \$250 for each taxpayer and spouse age 65 and older.

## CREDITS

A credit is an amount that is subtracted directly from the taxpayer's Wisconsin gross tax liability (i.e., the amount determined by applying the Wisconsin tax rates to Wisconsin taxable income) to determine the Wisconsin net tax liability.

### Itemized Deductions Credit

Federal law allows itemized deductions to be subtracted from federal adjusted gross income when these deductions exceed the federal standard deduction. Wisconsin does not allow itemized deductions, but instead has a credit for some of the expenses for which federal itemized deductions may be claimed. This credit is equal to 5% of the eligible itemized deductions in excess of Wisconsin's sliding scale standard deduction. The eligible expenses include medical expenses, interest and charitable contributions. No credit is allowed for the federal itemized deductions for state and local taxes, casualty and theft losses, and miscellaneous expenses.

The expenses used in calculating the Wisconsin itemized deductions credit are described below, and their fiscal effects are estimated. The sum of these estimates for each particular expense exceeds the total fiscal effect for the itemized deductions credit because of interaction effects.

#### 1. Medical Expenses

Most health expenses can be claimed as an itemized deduction to the extent that the total amount of medical expenses not compensated for by insurance exceeds 7.5% of the taxpayer's federal adjusted gross income. Eligible expenses include: fees for doctors, dentists, health practitioners and hospital services; amounts spent for prescription medicine and drugs; premiums paid on medical or health insurance policies; costs of medical equipment (e.g. motorized wheelchairs, hearing aids, dentures, eye glasses); and the cost of transportation, meals and lodging for needed medical care. The credit for medical expenses reduced tax revenues by \$22 million in FY04.

#### 2. Interest

Mortgage interest on a primary personal residence located in Wisconsin qualifies for the state's itemized deductions credit. Wisconsin also allows the credit for interest paid on indebtedness related to investments can be claimed as an itemized deduction to the extent that the investment interest is offset by the taxpayer's net investment income and to the extent that income is subject to Wisconsin tax. The revenue loss from the credit for interest expense was \$189 million in FY04.

Interest paid on indebtedness related to business, rental and royalty property is subtracted separately in determining the net income from the business, rental or royalty activity; see the section on "Deductions Which Further Define Net Income."

### 3. Charitable Contributions

Contributions to recognized charitable organizations or activities can be claimed as an itemized deduction. In general, a recognized charity is any governmental body or any public or private corporation, trust or foundation organized and operated principally for charitable, religious, scientific, literary or educational purposes. Certain limitations apply on contributions of property or the taxpayer's personal services. Additional limitations apply on the total amount of charitable contributions that can be deducted within a single year. The revenue loss from the credit for charitable contributions was \$86 million in FY04.

### School Property Tax Credit

The school property tax credit is equal to 12% of the first \$2,500 of property taxes or rent constituting property taxes paid on a person's primary residence and contiguous land, up to a maximum credit of \$300. For renters, "rent constituting property taxes" means 25% of rent if heat is not included or 20% of rent if heat is included in rent. No credit is allowed for property taxes or rent that is deductible as a trade or business expense.

### Working Families Credit

The working families credit equals a taxpayer's net tax liability, defined as gross tax less the itemized deductions, school property tax and historic rehabilitation credits, when income is less than \$18,000 for married couples filing jointly and \$9,000 for other tax filers. Essentially, the credit eliminates tax liability when income is below these ceilings. The credit is phased out over the next \$1,000 of income above these ceilings. The credit is limited to full-year residents, and no credit is allowed for persons who are claimed as a dependent on another filer's tax return.

### Married Couple Credit

Wisconsin provides a credit for married couples when both spouses are working to offset the marriage tax penalty facing two-earner couples. A penalty occurs when a married couple pays more tax than what they would if the two spouses were taxed as two single filers. The credit equals 3% of the first \$16,000 of earnings, resulting in a maximum credit of \$480.

### Armed Forces Member Credit

Wisconsin allows a nonrefundable credit of up to \$200 for military pay received for service while stationed outside the United States, to the extent this pay is included in WAGI. If both spouses of a married couple filing jointly receive pay for military service outside the country, each may claim the \$200 credit. The credit is allowed for full-year residents of Wisconsin only.

### Credit for Sales Tax on Fuel and Electricity Used in Manufacturing

Owners of noncorporate businesses, such as sole proprietorships, partnerships and limited liability companies treated as partnerships, may claim a nonrefundable credit for the amount of sales tax paid on fuel and electricity consumed in manufacturing tangible personal property in the state. Unused credits may be carried forward and offset against tax liability over the next 15 years. This credit, which is being replaced by a sales tax exemption for fuel and electricity used in manufacturing beginning in 2006, is described more fully in the "Corporate Income and Franchise Tax" chapter.

### Development Zone Credit

A development zone credit is available to taxpayers who are certified by the Department of Commerce to participate in the Wisconsin development zone program. Credits awarded to noncorporate entities are passed through to their owners in proportion to their ownership interest in the entity, and may be claimed on the owner's individual income tax return. The credit is nonrefundable, that is, limited to tax liability otherwise due. However, unused amounts may be carried forward. This program and the credit is more fully discussed in the chapter on "Corporate Income and Franchise Taxes."

### **Angel Investment Credit and Early Stage Seed Investment Credit**

Beginning in tax year 2005, the angel investment credit is available to individuals for investments in qualified new business ventures certified by the Department of Commerce. A credit for 12.5% of the investment may be claimed in each taxable year for two years. The maximum amount eligible for the credit is \$500,000 for each investment. The amount of credit that may be claimed by all taxpayers in any taxable year is limited to \$3 million and the total amount of credits that may be claimed for all taxable years is \$30 million.

Also beginning in tax year 2005, the early stage seed investment credit is available for businesses and individuals for 25% of qualified investments, with a maximum credit of \$3.5 million per taxable year and \$35 million for all taxable years. A more detailed description of the credit can be found in the Corporate Income and Franchise Tax chapter.

Both these credits expire after tax year 2014.

### **Historic Preservation Credits**

Two nonrefundable credits are provided to encourage the rehabilitation of historic buildings in Wisconsin.

#### **1. Supplement to the Federal Historic Rehabilitation Credit**

The supplement to the federal historic rehabilitation credit, equal to 5% of qualified rehabilitation expenditures, may be claimed for projects eligible for the federal credit. Qualified rehabilitation expenditures, defined under section 48 (g) of the Internal Revenue Code, are expenditures to substantially rehabilitate certified historic buildings for use in a trade or business. The rehabilitation work must meet historic preservation standards and the expenditures must exceed the taxpayer's adjusted basis in the building. Unused amounts of the credit may be carried forward for up to 15 years. The credit applies only to property located in Wisconsin. Taxpayers must reduce their Wisconsin adjusted basis in the building by the amount of the credit claimed. The reduced basis will result in lower depreciation deductions.

For rehabilitation projects undertaken by a partnership, tax-option corporation or limited liability company (LLC), the credit is passed through to the individual partners, shareholders or members in proportion to their ownership interest in the partnership, corporation or LLC.

#### **2. State Historic Rehabilitation Credit**

The state historic rehabilitation credit is equal to 25% of qualified expenditures to substantially rehabilitate certified historic buildings for noncommercial use. The credit applies to owner-occupied personal residences, provided that the residence is not used in the course of a trade or business. The credit cannot be claimed for rehabilitation of a personal residence if the person has already claimed a rehabilitation credit for another personal residence within the preceding five years. The rehabilitation work must meet historic preservation standards and the expenditures must exceed \$10,000. The maximum credit amount is \$10,000 (\$5,000 for married persons filing separately). Unused amounts of credit can be carried forward for up to 15 years. The credit applies only to property located in Wisconsin.

Taxpayers must reduce their Wisconsin adjusted basis in the building (or entire property, if not a building) by the amount of the credit claimed. The reduced basis will have the result that taxpayers may have an increased taxable gain from the sale or exchange of the property.

### **Earned Income Credit**

Wisconsin allows low-income workers with dependents to claim a Wisconsin earned income credit equal to a percentage of the federal earned income tax credit, depending on family size. The credit is refundable; any amount of the credit in excess of taxes otherwise due is rebated to the taxpayer.

The Wisconsin credit is 4% of the federal credit for persons with one child, 14% for persons with two children and 43% for persons with three or more children. For persons with one child the 2003 federal credit was 34% of the first \$7,490 of earnings, and for persons with two or more children the credit was 40% of the first \$10,510 of earnings. These federal credits were phased out as the greater of earnings or federal adjusted gross income rose from \$13,730 to \$29,666 for single persons with one child and from \$13,730 to \$33,692 for single persons with two or more children. The phase-out floors and ceilings are \$1,000 higher for married couples. The maximum credit and the range over which the credit is phased out are indexed to inflation. In addition, the

phase-out floor and ceiling for couples will be increased by \$1,000 in tax year 2004, by \$2,000 in tax years 2005 through 2007, and by \$3,000 for tax years after 2007.

Federal law also allows a credit for low-income workers without children; Wisconsin has no similar credit.

### **Homestead Credit**

Low-income homeowners and renters may qualify for an income tax credit or refund based on household income and property taxes or rent constituting property taxes. To qualify, the person:

1. Must be 18 years of age or older by the last day of the calendar year;
2. Must not be claimed as a dependent on anyone else's federal income tax return (unless the claimant is 62 years of age or older);
3. Must be a legal resident of Wisconsin for the entire calendar year;
4. Must have household income (of the claimant and spouse) of less than \$24,500.

In addition, persons are ineligible for the credit if they:

1. Live in a nursing home and receive medical assistance (Title XIX) at the time of filing the claim;
2. Live the entire year in housing that is exempt from property taxes;
3. Claim the farmland preservation credit for their home; or
4. Receive general relief payments of \$400 or more for each month of the year of claim, or public assistance (Aid to Families with Dependent Children or Temporary Assistance for Needy Families) for the entire year of claim.

For renters, property taxes are assumed to be 20% of rent if heat is included or 25% of rent if heat is not included in the rent. In computing household income, a claimant may deduct \$250 for each dependent living with the claimant.

For claims filed in 2004, the amount of credit was determined as follows:

1. If household income was \$8,000 or less, the credit was 80% of property taxes up to \$1,450; thus, the maximum credit was \$1,160.
2. If household income exceeded \$8,000 but was no more than \$24,500, the credit was 80% of the amount by which property taxes exceeded 8.778% of household income in excess of \$8,000.
3. If household income exceeded \$24,500, no homestead credit was allowed.
4. The maximum income, maximum property tax, and low income threshold are not indexed for inflation. These parameters were last increased for the 2000 tax year.

### **Income Taxes Paid to Other States/Income Tax Reciprocity**

If a person lives in one state and is employed in another, income may be subject to taxation in both states. To alleviate this double taxation, the state in which the taxpayer resides may allow a credit for income taxes paid to another state. Alternatively, two states may enter into a reciprocity agreement whereby the taxpayer is only required to pay state income taxes to the home state. Currently, Wisconsin has reciprocity agreements with Illinois, Indiana, Kentucky, Michigan and Minnesota.

## 1. Credit for Taxes Paid to Other States

Wisconsin residents may reduce their Wisconsin income tax by the amount of income taxes paid to other states (or the District of Columbia). The credit is not allowed if wages are earned in states having reciprocity agreements with Wisconsin. The revenue loss from this credit was \$85 million in FY04.

## 2. Income Tax Reciprocity

Since there are more Wisconsin residents employed in Minnesota and Illinois than residents of those two states working in Wisconsin, the income tax revenue foregone by those two states exceeds the taxes foregone by Wisconsin as a result of reciprocity. Either state could capture these additional revenues by eliminating reciprocity, but that would require individuals living in one state and working in the other to file income tax returns with both states. To avoid this and to eliminate the need for credits for taxes paid to the other state, Wisconsin has agreed to pay both Minnesota and Illinois an amount equal to the tax each state foregoes in excess of the amount of tax Wisconsin foregoes as a result of reciprocity. The payment to Minnesota includes interest calculated from July 1 of the tax year for which the payment is made until the date of the payment. Payments in FY04 were \$46,000,000 to Minnesota and \$28,000,000 to Illinois.

### Claim of Right Credit

A taxpayer who repays income in the current year that had been subject to tax in a previous year may claim a refundable credit for the amount of tax paid on that income in the previous year.

### Farmland Tax Relief Credit

A farmland tax relief credit equal to a percentage of property taxes up to \$10,000 on farmland, exclusive of improvements, is provided to owners of farmland. The Department of Revenue sets the credit percentage so that expenditures on the credit for all claimants, individual and corporate, is \$15 million, adjusted for expenditures in excess of or less than this amount in the prior fiscal year. For tax year 2003, the credit rate was 16%; the maximum credit is limited to \$1,500.

No credit is allowed for property taxes on farm buildings or other improvements on the farmland. The credit is refundable. To be eligible for the credit, the claimant must be domiciled in the state for the entire year and own the property on which the claim is based. This farmland must be at least 35 acres and be part of a farm that produces gross profits of at least \$6,000 in the year the credit is claimed, or \$18,000 in total for the year the credit is claimed and the two prior years.

### Farmland Preservation Credit

The Farmland Preservation Credit program allows owners of Wisconsin farmland to reduce their state income tax liability by a percentage of the property taxes paid on the land. The purpose of the credit is to encourage farmers to keep their land in agricultural use.

To be eligible for the credit, the following conditions must be met:

1. The claimant must be a resident of the state for the entire year for which the credit is claimed and must own the land for which the credit is claimed.
2. The farmland upon which the claim is based must be zoned exclusively for agricultural use or the claimant must have signed a farmland preservation agreement.
3. The farmland on which the claim is based must be at least 35 acres and must produce at least \$6,000 in gross farm receipts in the year for which the credit is claimed, or a total of \$18,000 in gross farm receipts in the year for which the credit is claimed and the two preceding years. If at least 35 acres of the farmland is enrolled in the federal Conservation Reserve Program, the farmland does not have to meet the gross farm receipts test.
4. The claimant or his or her spouse may not claim a homestead credit for the same period as that for which the farmland credit is claimed. In addition, only one member of a household may claim the farmland credit.
5. The claimant must certify that all taxes owed by the claimant on the farmland for the year before the year for which the claim is made have been paid.

6. The claimant must be in compliance with county soil and water conservation standards.

The maximum credit is \$4,200. The following table gives examples of potential credit amounts for selected combinations of income and property tax.

**TABLE 4**  
**REAL ESTATE TAXES LEVIED ON THE FARMLAND**

Household Income	Real Estate Taxes Levied on the Farmland in the Tax Year for Which the Claim Is Based	Potential Credit
\$ 5,000	\$2,000	\$1,800
10,000	2,000	1,485
15,000	4,000	2,640
20,000	4,000	2,255
25,000	5,000	2,360
30,000	6,000	2,115
50,000	6,000	600

The claimant receives 70%, 80%, 95% or 100% of the potential credit, depending on whether the claimant has a farmland preservation agreement or participates in the program through zoning, and on the type of action the county and municipality have taken on the agricultural preservation plan or zoning ordinance. The Department of Agriculture, Trade and Consumer Protection can inform claimants of the percentage they can expect to receive. The minimum credit is 10% of excessive property tax.

The amount of any Farmland Preservation Credit received is treated as income for Wisconsin tax purposes and must be reported as such on the claimant's tax return for the year in which it is received. The reason for this treatment is that property taxes on farmland are a deductible business expense that the farmland owner has already claimed as a deduction in calculating federal adjusted gross. The credit is added back to reduce the deduction to the amount actually by the landowner, that is the amount, of the tax less the credit.

Under certain circumstances, if a farmland owner removes land from the Farmland Preservation Program, tax credits received on the land, for the preceding 10 years, including interest on the credits, must be repaid.

### **DEDUCTIONS WHICH FURTHER DEFINE NET INCOME**

This report estimates the cost to the state of providing exemptions from the income tax for items that would otherwise be taxable. In earning a trade or business income, certain expenses are necessarily incurred, and individuals are allowed to deduct these expenses in determining the net income from the trade or business subject to tax. These deductions are described below, but their fiscal effect is not estimated because they are not truly exemption devices. Rather, they are used to define net income, upon which the income tax is imposed.

#### **Trade and Business Expenses**

A deduction from gross income is allowed for the ordinary and necessary expenses that are directly attributable to a trade or business carried on by the taxpayer. Services by the taxpayer as an employee are not considered a trade or business. Examples of expenditures normally allowed as deductions include: employee compensation and benefits, the cost of operations, fuel and electricity, advertising expenses, interest paid, insurance, legal fees, bad debts, depreciation, amortization, and depletion.

#### **Employee's Trade and Business Expenses**

Employees are allowed to deduct from gross income certain trade and business expenses that are incurred in the performance of job-related services for their employers. For purposes of computing adjusted gross income, the deduction is limited to:

1. All costs (including entertainment expenses) incurred in connection with one's job for which reimbursement is received either through an expense allowance or some other means. Amounts constituting reimbursement for employee expenses must be included in gross income in most instances.

2. Travel expenses whether or not reimbursement is received for them. They include the cost of transportation, meals, lodging and the use of certain services, e.g. telephone services.
3. All business expenses of an outside salesperson, defined as an individual who solicits business as a full-time salesperson away from his or her employer's place of business. This deduction would cover items such as insurance, depreciation on an automobile or other vehicle, food, lodging, telephone charges and entertainment.

Federal regulations provide that if an employee receives a reimbursement exactly equal to his expenses and makes a sufficient accounting to the employer, he need not report the reimbursement as gross income, in which case none of the expenses may be deducted in determining adjusted gross income.

### **Expenses Related to Rent and Royalty Income**

The expenses related to rent and royalty income are deductible from gross income. These expenses include taxes, interest, depletion, depreciation and other expenses such as repairs, employee wages, utilities, insurance and losses.

## CORPORATE INCOME AND FRANCHISE TAX

Taxation of corporate income was enacted in Wisconsin in 1911, at the same time the individual income tax was created. Since enactment, the basic features of the corporate tax have remained fairly constant, with two noteworthy changes: a shift from graduated rates to a flat rate in 1981 and federalization of the tax base in 1987. In 1981, a series of rates and brackets were replaced with a single flat rate of 7.9%. Under the federalized state corporate tax in effect since 1987, corporate taxpayers are subject to tax on the Wisconsin apportioned share of their federal net taxable income, with a limited number of adjustments for the relatively few remaining federal/state law differences and the ongoing effects of previous law differences.

Corporations are actually subject to one of two state taxes. The corporate *income* tax, imposed since 1911, is a tax on the net income of corporations doing business in the state. The corporate *franchise* tax, imposed since 1965, is a tax on the privilege of doing business in the state. Corporate net income is used as the measure or base for the franchise tax. The distinction between the two taxes is a subtle one, relating primarily to the restrictions under federal law on the types of income that states can tax with an income tax (e.g., interest from U.S. obligations). The vast majority of corporations pay the franchise tax. The income tax applies to corporations whose business in Wisconsin consists entirely of foreign or interstate commerce, and corporations that are filing their final return before dissolution. Because both levies employ the same rate and the same general rules for determining corporate net income (although interest income from U.S. obligations cannot be taxed under the income tax), the two taxes are usually considered as one.

Wisconsin also imposes a recycling surcharge equal to 3% of the gross tax liability of regular (C) corporations and 0.2% of the net income of tax-option (S) corporations and other business entities. The surcharge and its exemptions are treated in a separate chapter.

Corporations that conduct business in more than one state must apportion their net income among the states with jurisdiction to tax the income. Wisconsin, like most states with corporate income or franchise taxes, uses an apportionment formula based on three factors – property, payroll and sales. In the Wisconsin apportionment formula, the sales factor is double-weighted (50%) and the property and payroll factors are single-weighted (25% each). Beginning in 2006, an apportionment formula based only on the sales factor will be phased in. The sales factor will be weighted at 60% for taxable years beginning in 2006, 80% in 2007 and 100% in 2008.

Wisconsin provides for differential tax treatment of business income depending on the form of organization under which a business or organization operates. The business income of proprietorships and partnerships is reported and taxed on the individual income tax returns filed by the owners of the business. Tax-option or Subchapter S corporations are corporations that have elected under Subchapter S of the Internal Revenue Code to have their business income taxed to the individual owners of the business in essentially the same manner as a partnership.

Businesses that are organized as regular, or Subchapter C, corporations pay the corporate income/franchise tax. In addition, under certain circumstances, the business income of nonprofit organizations and certain types of trusts can be subject to the state corporate tax.

1993 Wisconsin Act 112 authorized the formation of a new form of business organization, the limited liability company (LLC). LLCs combine the limited liability protection afforded to owners of corporations with the flow-through tax benefits provided to owners of S corporations and partners in partnerships. Generally, business income of LLCs is reported and taxed on the individual income tax returns of the owners (called members) of the business. However, some LLCs choose to be taxed as corporations, and their business income is reported as taxed on the corporate return.

### Collections

In FY04, corporate tax collections were \$651 million, or 6% of total general purpose revenue (GPR) taxes. Although corporate tax collections continue to be a major source of revenue for the state, they have declined as a share of total state tax revenues. Enactment and expansion of the state sales tax and growth of the individual income tax have reduced the relative importance of the corporate tax as a revenue source.

## Data Sources

Tax exemption devices applicable to the corporate income tax are grouped into five categories: exemptions, exclusions, special treatments, deductions and credits. The following data sources were used to estimate the fiscal effects of these exemption devices.

1. Wisconsin Corporate Income Tax Model. Fiscal estimates were based in part on data and analysis provided by a computerized corporate income and franchise tax model. Like the Individual Income Tax Model, the corporate model depends on scientifically selected samples of returns from state taxpayers. The model contains more than 5,000 corporate returns for tax year 2001, weighted to reflect the corporate tax filing population.
2. Wisconsin Corporate Tax Collection Statistics. Department of Revenue annual aggregate statistics of corporate tax collections and data from individual corporate returns were also used to estimate fiscal effects.
3. Wisconsin Econometric Model. The Wisconsin econometric model consists of several hundred statistical equations that together simulate the state economy. The model, used in conjunction with the national forecast and database of Global Insight, Incorporated, provided estimates for a variety of exemption devices.
4. Federal Tax Expenditure Estimates. The Congressional Budget Act of 1974 requires preparation of a federal tax expenditure budget annually. These "expenditures" reflect the cost in lost federal revenues of the wide variety of exemptions and incentives contained in the Internal Revenue Code. Using Congressional Budget Office, Joint Tax Committee and U.S. Department of Treasury figures, estimates of the fiscal effect of comparable provisions contained in state law were generated. The procedure followed was first to apportion the federal tax expenditure to Wisconsin, and then to adjust for the difference in state and federal tax rates.
5. Statistics of Income, *Corporation Income Tax Returns*. Published annually by the Internal Revenue Service, this document provides aggregate data for income and deduction amounts reported on federal returns. By apportioning the appropriate figures to Wisconsin using the 1.05% ratio of Wisconsin corporate income to U.S. income, and applying a marginal rate of 7.9%, fiscal estimates for some exemptions were obtained.
6. Annual Reports. Annual company reports served as additional sources of information and also as checks for other data. Among those industries whose reports proved beneficial were railroads, credit unions and insurance companies.
7. Miscellaneous Sources. Federal and state government agencies, which publish data relating to the corporate sector, and experts in specific areas of corporate taxation, such as the treatment of insurance companies, the legal status of the Menomonee Indians and bank liquidations, provided additional information.

Several methodological issues complicate the estimation of the revenue loss associated with corporate tax exemption devices. The major obstacle is the lack of useful data. For several exemptions, for example, cooperatives and nonprofit organizations, data needed to estimate the fiscal effect were not available. When data are available, they often only approximate the exempt income or deductible expenses for which an estimate is being made. Data may be several years old, which reduces its usefulness given the potential volatility in economic conditions across the nation, within the state, or within a particular industrial sector. Interest rates, price levels, industrial reorganizations and many other factors contribute to this volatility. Further, the corporate tax is imposed on corporate profits, which can be highly variable. Finally, the estimation process requires assumptions, for example, on Wisconsin's share of some national aggregate or the profitability of corporations operating in Wisconsin relative to firms nationwide. Frequently there is limited information on which to base these assumptions, so they may introduce errors into calculations.

**TABLE 1**  
**CORPORATE INCOME AND FRANCHISE TAX EXEMPTION DEVICES SUMMARY**

Exemption Devices	Statutory Reference*	FY04 Fiscal Effect
<b>Exemptions from Taxation</b>		
Governmental Units	s. 71.26 (1)(b) and (bm)	None
Nonprofit Corporations or Associations	s. 71.26 (a)	None
Nonprofit Organizations		\$39,300,000
Private Foundations		None
Cooperatives	s. 71.26 (1)(c)	None
Credit Unions	s. 71.26 (1)(a)	7,900,000
Insurance Companies	s. 71.43 (2) and 71.45 (1)	Not available
Banks Under Liquidation	s. 71.26 (1)(d)	Minimal
Assets Distributed to the Menomonee Indian Tribe	s. 71.26 (1)(e)	Minimal
Activities of Out-of-State Publishers and Certain Foreign Corporations	s. 71.23 (3)	Not available
<b>Exclusions From Income</b>		
Life Insurance Proceeds	IRC 101	Minimal
Exchanges of Corporate Property or Stock	IRC 1031 to 1033 and 1036 to 1038	Not available
Like-Kind Exchanges		Not available
Other Exchanges		Not available
Debt Cancellation Through Bankruptcy	IRC 108; 11 U. S. Code 1079	Not available
Recovery of Bad Debts, Prior Taxes and Delinquency Amounts	IRC 111	Minimal
Natural Resource-Related Cost-Sharing Payments	IRC 126	Minimal
Foreign Sales Corporations	IRC 921 to 927 prior to repeal by P.L. 106-519	12,800,000
<b>Special Treatment</b>		
Limit on Tax Liability of Insurers	s. 71.46 (3)	11,800,000
Urban Mass Transportation Companies	s. 71.39	None
RICs, REITs and REMICs	IRC 851 to 860 and 860A to 860G, s. 71.26 (2)(b)	Minimal
Double Weighting of the Sales Factor	s. 71.25 (6)	10,600,000
"Throwback" Sales	s. 71.25 (9)(b)2m and 3, and (9)(c)	14,400,000
Tax-Option Corporations	IRC 1361 to 1368 and 1374, ss. 71.32 to 71.365	Not available
Limited Liability Companies	ss. 71.19 to 71.21 and ch. 183	Unknown
<b>Deductions from Gross Income</b>		
Deductions Which Further Define Net Income	Various IRC sections	Not applicable
Amortization and Other Special Cost Recovery	IRC 169, 173 to 175, 178, 180, 190, 193 to 195, 263(c), 291, 611, 612, 616 and 617	Minimal
Allowances		5,400,000
Circulation Expenditures		Not available
R&D Expenditures		Minimal
Conservation Expenditures		Minimal
Lease Acquisition		Minimal
Fertilizer Expenditures		Minimal
Architectural Barriers		Minimal
Tertiary Injectants		Minimal
Reforestation Expenditures		Minimal
Start-Up Expenditures		300,000
Intangible Drilling Costs		Minimal
Mine Exploration		Minimal
Other Amortization		Not available
Charitable Contributions	IRC 170	4,300,000
Depreciation—Accelerated and Modified Cost Recovery System and Expensing Election	IRC 167, 168 and 179	
Accelerated Recovery	s. 71.26(3)(y)	Not available
Section 179 Expensing		Not available
Dividends	IRC 591 and 1382; s. 71.26 (3)(j)	
Dividends Received		Not available
Patronage Dividends		Not available
Depositor's Dividends		Not available

**TABLE 1**  
**CORPORATE INCOME AND FRANCHISE TAX EXEMPTION DEVICES SUMMARY, continued**

Exemption Devices	Statutory Reference*	FY04 Fiscal Effect
<b>Deductions from Gross Income, continued</b>		
Bad Debt Reserves of Financial Institutions	IRC 585 and 593	240,000
Net Operating Loss Carryforward	s. 71.26 (4)	64,400,000
<b>Credits</b>		
Credit for Sales Tax on Fuel and Electricity Used in Manufacturing	ss. 71.28 (3) and 71.47 (3)	18,000,000
Manufacturing Investment Credit	ss. 71.28 (3t) and 71.47 (3t)	None
Research Expenditures Credit	ss. 71.28 (4) and 71.47 (4)	11,400,000
Research Facilities Credit	ss. 71.28 (5) and 71.47 (5)	300,000
Supplement to Federal Historic Rehabilitation Credit	ss. 71.28 (6) and 71.47 (6)	1,300,000
Development Zone, Development Opportunity Zone, Enterprise Development Zone and Agricultural Development Zone Credits	ss. 71.28 (1dx), (1dm), (1di) and 71.47 (1dx), (1dm) (1di)	8,600,000
Technology Zone Credit	ss. 71.28 (3g) and 71.47 (3g)	Minimal
Dairy Investment Credit	ss. 71.28 (3n) and 71.47 (3n)	None
Early Stage Seed Investment Credit	ss. 71.28 (5b) and 71.47 (5b)	None
Farmland Tax Relief Credit	ss. 71.28 (2m) and 71.47 (2m)	600,000
Farmland Preservation Credit	ss. 71.28 (2), 71.47 (2) and 71.57 to 71.61	280,000
Community Development Finance Company	ss. 71.28 (1) and 71.47 (1)	None
Insurance Security Fund Assessments	s. 646.51 (7)	Minimal

\* References to sections of the 2003 Wisconsin Statutes, except "IRC" indicates a reference to a section of the federal Internal Revenue Code authorizing the exemption device.

## EXEMPTIONS FROM TAXATION

An exemption allows certain types of organizations, or certain activities related to those organizations, to be free of Wisconsin corporate franchise or income taxes.

### Governmental Units

All political units are exempt from income taxation. This includes the federal and state governments, counties, cities, towns, villages, school districts, technical college districts, and special governmental districts like sewerage treatment districts and family care districts. Also exempt are quasi-governmental districts formed for some special public purpose, including local exposition, professional baseball park, professional football stadium and local cultural arts districts.

Under the provisions of the United States Constitution, states cannot tax the assets or income-generating activities of the federal government. The state does not tax the assets or income-generating activities of local governments. Defining the net income of local government activities would be difficult, since such activities are generally not trades or businesses. In the case of activities that could be considered trades or businesses, such as municipal water utilities or public golf courses, the activities rarely result in net income to the local government.

### Nonprofit Corporations or Associations

All religious, scientific, educational, benevolent or other corporations or associations not organized or operated for profit are exempt from taxation on income from activities related to their tax-exempt purpose. Examples include college alumni groups, scouting organizations, religious and other not-for-profit nursing homes, community-based fund-raising drives for the needy, public interest research groups, and foundations.

Nonprofit organizations with income from business activities that are not related to their tax-exempt purpose are subject to a corporate-level unrelated business income tax (UBIT) similar to the federal UBIT. Certain types of income, such as royalties, are not included in UBIT.

Nonprofit organizations are not subject to tax on income from contributions and business activities related to their tax-exempt purpose because this income is used to provide the public services for which these organizations

exist. The fiscal effect from this exemption is shown to be zero because if nonprofits were subject to tax, they would have little or no income subject to tax.

Private foundations are treated differently since their activities tend to be more restricted than tax-exempt nonprofit organizations. Foundations generally do not conduct activities; rather, they provide grants to other organizations to conduct the activities. Thus, the investment income of foundations greatly exceeds their low amount of operating costs. Since 1969, the federal government has imposed an annual excise tax on the net investment income of private foundations and a series of penalty levies linked to the failure of foundations to meet certain specified operating requirements. The state does not impose a similar annual excise tax on private foundations.

### **Cooperatives**

Cooperatives organized under Chapter 185 of the Wisconsin Statutes are exempt from income taxation, provided they operate without profit to any shareholder or member and distribute their proceeds according to the procedures set out in sec. 185.45, Wis. Stats. Cooperatives may be organized for any lawful purpose except banking or insurance.

Agricultural cooperatives engaged in marketing farm products for producers, and associations or corporations that process and market farm products for such cooperatives, are exempt from income taxation. To retain their exemption status, cooperatives must: 1) have at least 25 members, 2) return to producers the net proceeds resulting from sale of their products, and 3) in the preceding five years have limited payments of members' dividends to no more than 8% per year. Corporations processing and marketing farm products for agricultural co-ops are additionally required to deal solely in farm products and cannot charge more than a sufficient amount to cover the costs of: 1) marketing and processing, 2) payment of dividends not to exceed 8% per year, and 3) a 5% addition to surplus.

Because cooperatives, by definition, do not operate for profit, they would not have a taxable net income if subject to tax. Thus, the exemption has no fiscal effect. Distributions made by cooperatives to the cooperative members may be taxable, depending on the nature of the distribution (see the discussion of patronage dividends under the section on "Deductions from Gross Income").

### **Credit Unions**

Federally-chartered credit unions are exempt from state taxation under federal law. Wisconsin exempts state-chartered credit unions from taxation, except for the portion of their net income attributable to public deposits from the state or local governments. There are approximately 300 credit unions operating in Wisconsin; most of them are state chartered.

The estimate does not take into account the fact that, if credit unions did lose their exempt status, they would most likely receive much of the same favorable tax treatment accorded other financial institutions.

### **Insurance Companies**

The following insurance companies are exempt from income taxation:

- Insurance companies exempted under section 501 (c)(15) of the Internal Revenue Code. This section exempts companies other than life insurance companies whose net written premiums (or, if higher, their direct written premiums) do not exceed \$350,000.
- Town mutual companies organized under Chapter 612 of the Wisconsin Statutes.
- Foreign insurance companies, that is, any insurance company organized outside the state of Wisconsin.
- Domestic life insurance companies engaged exclusively in life insurance.
- Domestic insurance companies insuring against losses relating to mortgages.

In general, only domestic insurers pay the corporate franchise tax to the Department of Revenue, based on the portion of their net income attributable to lines of insurance other than life insurance. There are between 100 to 150 insurance companies subject to the franchise tax. Other insurance companies pay a premium tax (\$108.9 million in collections in FY04) to the Office of the Commissioner of Insurance, based on the amount of premiums

written in Wisconsin. According to the annual report of the Office of the Commissioner of Insurance, there are nearly 2,000 insurance companies with operations in the state, of which about 370 are domestic companies. Of the domestic companies, about 70 are town mutual companies. The fiscal effect of this exemption is unknown since it is not clear how income subject to tax would be defined.

### **Banks Under Liquidation**

Banks placed in the hands of the Division of Banking, Wisconsin Department of Financial Institutions, for liquidation under sec. 220.08, Wis. Stats., are exempt from tax if such taxation would diminish the financial assets needed to make full payment to depositors. There have been relatively few bank liquidations in Wisconsin since the Depression in the 1930s. It is unlikely that this pattern will change. If it did, very little tax revenue could be expected from financial institutions undergoing liquidation.

### **Assets Distributed to the Menominee Indian Tribe**

Assets distributed by the U.S. government to members of the Menominee Indian Tribe or any corporations or organizations created by the tribe are exempt from state taxation. In addition, stocks, bonds and other securities issued by tribal corporations or organizations are exempt from state tax.

Under federal law, states generally do not have the authority to tax business activities of Indian tribes provided that the activities are conducted on reservation property or property held in tribal trust.

### **Activities of Out-of-State Publishers and Certain Foreign Corporations**

Under federal law, a state has jurisdiction to tax the Wisconsin-apportioned share of the net income of an out-of-state corporation only if the corporation has nexus – that is, a business presence – in Wisconsin. A corporation generally has nexus in Wisconsin if it has property or employees (i.e., payroll) in the state on a regular basis. Certain exceptions to the nexus rules exist so that some out-of-state corporations will not be subject to the Wisconsin income and franchise tax.

Wisconsin allows the following exemptions from nexus:

- The storage of property with a firm in this state for purposes of fabricating, processing, manufacturing or printing the property for an out-of-state corporation.
- The storage of property on the premises of a Wisconsin firm when the intent is to distribute the goods outside the state.
- The printing, storage and distribution of books, magazines and other publications for out-of-state publishing companies that contract with Wisconsin printing firms.
- The storage of property in Wisconsin for no more than 90 days by foreign corporations, provided the property is stored at a site not owned by the foreign corporation and is transferred and used in the state for fabricating, processing, manufacturing or printing on the site where the property is stored. Further, the assessed property value of the site where the property is stored and transferred must be at least \$10 million but not more than \$11 million on January 1, 1999.

The out-of-state corporations usually have no payroll or plant and equipment in Wisconsin. Thus, the act of storing property in the state for processing, printing or other temporary purposes would have been the only factor establishing nexus, and in turn, a Wisconsin tax liability for the corporations, in the absence of these exemptions.

### **EXCLUSIONS FROM INCOME**

An exclusion is an item that is not included in the definition of gross income. Excluded income normally does not have to be reported on the tax return.

#### **Life Insurance Proceeds**

Amounts received by a corporation from an insurance company or any other insurer as payment for a death claim are exempt from income taxation. For example, if a company took out policies on the lives of its board members and was paid the value of insurance on the life of one of the board members upon his or her death, the insurance

benefit would not be included in the income of the corporation subject to tax. However, the company could not claim a business expense deduction for the premiums it paid on the policy.

Companies are believed to represent a small proportion of all beneficiaries. Further, because insurance compensation is usually paid on the deaths of individuals past retirement age, the effect of this provision is thought to be small.

### **Exchanges of Corporate Property or Stock**

In general, gain will be recognized as a result of an exchange or disposition of property to the extent that any cash proceeds, plus the taxpayer's basis in new property, exceeds the taxpayer's basis in the old property. However, gains from the following types of transactions are excluded from gross income:

- Exchange of property held for productive use in a trade or business or held for investment for like-kind (i.e., similar) property. Examples of like-kind exchanges are an exchange of a delivery truck for a delivery van, and an exchange of one real property for another real property. The nonrecognition of gain does not apply to exchanges involving inventory and intangible investments, such as stocks and bonds, or to any exchanged property disposed of within two years by either party, with exceptions for death or involuntary conversions.
- Exchange of stock in the corporation for property. For example, a shareholder might contribute property to a corporation for additional shares of stock.
- Involuntary conversions. There is no recognition of gain from involuntary conversions of property provided that the property is converted into similar property, or if it is converted into money used to acquire similar property.
- Exchange of common or preferred stock in a corporation for similar stock in the same corporation. For example, a shareholder might be allowed to convert 100 shares of old stock into 200 shares of new stock.
- Certain exchanges of United States obligations. There is generally no recognition of gain if United States obligations must be surrendered in exchange solely for other United States obligations.
- Certain reacquisitions of real property. There is generally no recognition of gain if the seller of real property reacquires a real property in exchange for satisfaction of indebtedness secured by the real property.

The fiscal effects of these exemption devices generally are small because they represent a postponement of income that will eventually be taxed. In general, the taxpayer's basis in the new property is equal to the basis in the old property, or otherwise reduced to take into account the fact that the property was acquired in a tax-free transaction.

### **Debt Cancellation Through Bankruptcy**

When debt is forgiven in connection with a bankruptcy proceeding, the income realized is not subject to tax unless the principal purpose of the bankruptcy plan is to evade income taxes. No information is available on which to estimate the fiscal effect of this exemption device.

### **Recovery of Bad Debts, Prior Taxes and Delinquency Amounts**

Receipts generated by the recovery of bad debts, prior taxes or delinquency amounts are excluded from gross income to the extent that they did not reduce income tax liability when deducted in a prior year. The portion of a recovery amount that gave rise to a tax benefit in prior years is taxable.

### **Natural Resource-Related Cost-Sharing Payments**

Payments received by corporations primarily for the purpose of conserving soil and water resources, protecting or preserving the environment, improving forests, or providing a habitat for wildlife may be excluded from gross income.

## Foreign Sales Corporations

Until 2000, federal law exempted a portion of the foreign trade income of a foreign sales corporation (FSC) from federal tax, provided that the income was derived from the foreign presence and business activity of the FSC. Following a ruling by the World Trade Organization (WTO) that the FSC provides an unfair trade advantage to these companies, the FSC exemption was repealed and replaced with an extraterritorial income exclusion. Wisconsin did not adopt the federal FSC repeal and enactment of Extraterritorial Income Exclusion Act of 2000, which provided the new scheme to address WTO concerns. As a result, companies meeting the requirements of the former federal FSC exemption may still exclude income from tax in Wisconsin. The Extraterritorial Income Exclusion Act also was ruled illegal by the WTO and in 2004 the federal American Jobs Creation Act was enacted. Wisconsin has not yet determined whether it will follow the provisions of this new federal law.

The special tax treatment of the FSC is designed to stimulate export sales by domestic firms. The FSC must be a separately incorporated exporting entity, recognized under the laws of a foreign country or United States possession, and must maintain an office outside the United States. Distributions from the FSC to the parent corporation are generally eligible for the dividends-received deduction for dividends from controlled subsidiaries (see the discussion of dividends under the section on "Deductions from Gross Income").

## SPECIAL TREATMENT

Certain corporate entities are subject to tax provisions that are substantially different from those provided for most corporations. While these entities pay corporate franchise or income taxes, the method used to compute the tax liability is different from that afforded other corporate taxpayers.

### Limit on Tax Liability of Insurers

The tax liability of insurance companies subject to the state income/franchise tax (see the discussion under the section on "Exemptions") is limited to 2% of the gross premiums derived from non-life lines on insurance in Wisconsin.

### Urban Mass Transportation Companies

Any corporation deriving 50% or more of its gross income from urban mass transportation is assessed a special tax of one-half of taxable income. Before the imposition of this tax, an amount equivalent to 8% of the depreciated cost of property used or useful in business, as well as federal income tax payments, are deductible; interest paid is not. No revenue has been collected under this special tax levy since 1974.

There are approximately 23 county or municipality-owned urban mass transportation companies in Wisconsin, with the vast majority of revenues coming from operations in Milwaukee, Madison, Racine, Eau Claire and Green Bay. Because each of these companies generally registers losses or no net income, this exemption has no fiscal effect.

## RICs, REITs and REMICs

Certain types of corporations are substantially or fully exempt from tax at the corporate level provided that they meet certain percentage requirements for distributions to shareholders. These corporations are generally organized as investment vehicles and do not carry on a trade or business other than the investment activities.

A regulated investment company (RIC) must derive its income primarily from interest, dividends and gains from the disposition of stock and securities. Most mutual funds are organized as RICs. At least 90% of a RIC's income must be distributed to its shareholders each year. If so, the corporation is allowed a deduction for the distributions to shareholders. This deduction reduces the corporation's net taxable income to a minimal amount and effectively eliminates any corporate tax liability. Failure to meet the distribution requirements results in the denial of the deduction and a substantial corporate tax liability.

A real estate investment trust (REIT) specializes in real estate investments and must derive its income primarily from rents from real property, other real property income, interest, dividends and gains from the disposition of stock and securities. At least 90% of a REIT's income must be distributed to its shareholders each year. The taxation of REITs is essentially the same as the taxation of RICs in that a deduction for distributions to shareholders is allowed if the corporation meets the distribution requirement.

A real estate mortgage investment conduit (REMIC) is an entity that holds a fixed pool of mortgages and issues multiple classes of ownership interests to investors. In general, a REMIC is treated in a manner similar to a partnership. Thus, the net income of a REMIC is taxable to the holders of the interests in the REMIC.

There are relatively few of these types of investment corporations operating in Wisconsin. In addition, any income not taxed to the corporation is generally taxed to the shareholders. Thus, the fiscal effect of this exemption device is minimal.

### **Double Weighting of the Sales Factor**

Wisconsin requires multijurisdictional corporations to compute the amount of income taxable in this state through the use of a three-factor apportionment formula. The factors in the formula are based on the relationship of a company's property, payroll and sales in Wisconsin to the total property, payroll and sales in all jurisdictions. Each factor represents a ratio that is assigned a weight and then combined to yield a single income apportionment percentage.

Since 1974, Wisconsin has used an apportionment formula that double weights the sales factor. As such, the sales factor has a weight of 50% in the formula and each of the payroll and property factors are weighted at 25%. Double-weighting of the sales factor favors corporations with sales on a regional or national basis that have significant property and payroll in state.

The fiscal effect of this exemption device is the difference in tax liability under a double-weighted sales factor as compared to a formula that weights each factor equally. The revenue loss from tax savings to the corporations that benefit from double-weighting the sales factor is offset somewhat by revenue gains from the increased taxes paid by corporations that would have had lower tax liabilities if the sales factor was single-weighted.

Beginning in 2006, single sales factor apportionment will be phased in. The sales factor will be weighted at 60% for taxable years beginning in 2006, at 80% in 2007 and at 100% in 2008.

### **"Throwback" Sales**

A multistate corporation subject to tax in Wisconsin is required to treat certain "throwback" sales as Wisconsin sales when calculating its sales factor using the multistate apportionment formula. Throwback sales are sales originating in Wisconsin made to the federal government or to customers located in states where the seller is not subject to tax because of the nexus standards defined by federal law and interpreted by the Wisconsin Administrative Code.

Under the nexus standards, a corporation must have some type of operations in a state, generally in the form of property or employees, before its income can be taxed by that state. Without nexus, a state cannot tax a corporation. The throwback rule ensures that a corporation's entire income is subject to apportionment by the states with jurisdiction to tax. Without the throwback rule, sales to destination states in which the seller does not have nexus would not be included in the numerator of the sales factor of any state, and a corporation would be able to avoid paying tax on some of its income.

Sales shipped from Wisconsin to the federal government outside the state are thrown back to Wisconsin and single-weighted, as are sales shipped outside the state to taxpayers not within the income and franchise tax jurisdiction of the destination state. In-state sales to the federal government continue to be double-weighted.

The estimate is based on the difference of single-weighting the throwback sales compared to double-weighting those sales under the regular apportionment formula.

### **Tax-Option Corporations**

A tax-option corporation is a corporation with not more than 75 individual shareholders that elects Subchapter S treatment under Section 1362 of the Internal Revenue Code. Under Subchapter S, the corporation is exempt from tax at the corporate level and the net income is taxed to the individual shareholders under the individual income tax on a pro rata basis. The net income is taxed to the shareholders regardless of whether the corporation makes any actual distributions to the shareholders. In general, Subchapter S corporations are treated in a manner similar to partnerships, and items of income retain their character as they flow through to the shareholders.

Most federal Subchapter S corporations are automatically treated as tax-option corporations for state purposes. However, Subchapter S corporations can elect to be treated as regular corporations for state purposes under certain conditions. Regular corporations converting to Subchapter S or tax-option treatment are subject to a special tax on built-in gains for both federal and state purposes. Effective with tax years beginning on or after January 1, 1989, tax-option corporations and their shareholders can no longer deduct state taxes in calculating net income.

### **Limited Liability Companies**

Limited liability companies (LLCs) are a type of business entity that may be taxed similar to corporations or partnerships, depending on how they are structured. If taxable as a partnership, owners of an LLC (called members) are taxed on the flow-through income of the company at lower individual rates, rather than at the higher corporate rate. However, if taxable as a corporation, an LLC is taxed at the entity level using the corporate income tax rate.

### **DEDUCTIONS FROM GROSS INCOME**

A deduction is an amount subtracted from Wisconsin gross income (or total income) to establish Wisconsin taxable income – the amount to which the tax rate is applied.

#### **Deductions Which Further Define Net Income**

Sec. 71.23, Wis. Stats., subjects corporations to a tax on or measured by their net income. Net income is defined as gross income less allowable deductions. The very nature of the corporate tax thus requires that income be reduced by certain current expenses and allocated costs. These expenses include: wages and salaries, taxes, repairs, rents, interest, and the cost of employee benefits. These expenses are generally legitimate business outlays.

#### **Amortization and Other Special Cost Recovery Allowances**

The cost associated with the consumption of an asset can be recovered in several ways. When an asset has a fixed life, costs are generally recovered through depreciation, which is discussed later in this section. For assets with indeterminate lives, the cost recovery methods include amortization, depletion and special cost recovery allowances. In addition, special cost recovery provisions apply for other types of costs that otherwise would not be recovered until the asset is disposed of, income is received for the product or service for which the cost was incurred, or the corporation is dissolved. The costs are eligible for recovery techniques that allow taxpayers to recover costs sooner than would otherwise be allowed.

1. **Pollution control facilities.** The cost of certain pollution control facilities can be amortized over a period of five years. To qualify, the pollution control facility must be used in connection with a plant in operation prior to 1976.
2. **Circulation expenditures.** Costs (other than costs to acquire land, depreciable property and part of the business of other newspapers or periodicals) to establish, maintain or increase the circulation of newspapers and periodicals can be deducted in the year paid.
3. **Research and development expenditures.** Costs of noncapital research and experimental activities can be deducted in the year paid or amortized over a period of five years (see also the discussion of noncapital expenditures under the Research Expenditures Credit in the section on "Credits").
4. **Soil and water conservation expenditures.** Taxpayers engaged in farming can deduct, in the year paid, the costs of soil and water conservation practices that are consistent with a conservation plan approved by the Soil Conservation Service of the U.S. Department of Agriculture. The deduction cannot exceed 25% of gross income from farming.
5. **Lease acquisition.** The cost of acquiring a lease, including renewal options, can be deducted in the year paid if certain requirements are met.
6. **Fertilizer expenditures.** Taxpayers engaged in farming can deduct the cost of fertilizers, lime and other materials used to condition land utilized in farming in the year paid.

7. Architectural barriers to disabled people. Up to \$15,000 of costs to remove architectural and transportation barriers to the disabled and elderly can be deducted in the year paid.
8. Tertiary injectants. Costs of tertiary injectants, used as part of tertiary recovery methods for oil and gas, can be deducted in the year paid.
9. Reforestation expenditures. Up to \$10,000 of costs to reforest qualified timber property can be amortized over a period of seven years.
10. Start-up expenditures. Costs of incorporating the taxpayer's business and issuing stock for the business can be amortized over a period of five years.
11. Intangible drilling costs. Operators of a domestic oil, gas, or geothermal well may elect to expense intangible drilling and development costs, rather than capitalizing the costs through depletion or depreciation. For operators of wells located outside the U.S., costs can be recovered over a 10-year, straight-line amortization schedule or added to the adjusted basis of the property for cost depletion, at the choice of the taxpayer.
12. Mine exploration and development. A portion of the costs of exploring for energy and mineral deposits and developing such deposits for mining or drilling can be deducted in the year paid. The remaining portion is amortized over a period of five years.

Depletion allowances are provided to allow taxpayers to recover the costs of capital investment in natural resources. Under the cost depletion method, the acquisition costs are divided by the estimated number of units that the deposit or resource will produce. Taxpayers are allowed an annual deduction equal to the current year's production multiplied by the per unit depletion cost. Federal law also allows taxpayers the option of using percentage depletions, which provides taxpayers with an annual deduction equal to a percentage of the gross income from the current year's production.

For state purposes, only cost depletion is allowed. Since cost depletion does not allow for rapid cost recovery in the way that percentage depletion does, cost depletion is not considered an exemption device.

The special expensing provision for depreciable property under Section 179 of the Internal Revenue Code is discussed under Depreciation in this section.

### **Charitable Contributions**

Contributions by corporations to the following charities are deductible from gross income:

- The state or any other political subdivision, as long as the gift is for strictly public purposes.
- A corporation, trust or community chest, fund or foundation operating for strictly religious, charitable, scientific, literary or educational purposes, or for fostering national or international sports competition, or for the prevention of cruelty to children or animals.
- Veterans' organizations and an auxiliary unit, society, trust or foundation of such organizations.
- Member-owned or nonprofit cemetery corporations chartered solely for burial purposes.

Certain limitations apply to the amount of contributions that can be claimed as a deduction and to the amount that can be deducted for contributions of property. In general, the deduction for charitable contributions cannot exceed 10% of a corporation's taxable income. Amounts of contributions not deductible in the current year can be carried forward for five years and claimed as a deduction.

### **Depreciation – Modified Accelerated Cost Recovery Systems and Expensing Election**

Depreciation deductions are allowed to reflect the reasonable expenses incurred by taxpayers for exhaustion, wear and tear of property used in a trade or business or held for the production of income. Effective for tax year 1987, the state adopted the Modified Accelerated Cost Recovery System (MACRS), enacted as part of the federal Tax Reform Act of 1986. However, property placed in service prior to that time must continue to be depreciated according to the state restrictions in effect at the time the property was placed into service.

Under MACRS, eligible property is generally assigned to a depreciation recovery class of 3 years, 5 years, 7 years, 10 years, 15 years or 20 years, 25 years, 27.5 years, 31.5 years or 39 years, depending upon the type of property. The cost of the property is recovered using statutory recovery methods and conventions.

With some restrictions, Section 179 rules allow taxpayers to expense in the current year up to \$25,000. To qualify as Section 179 property, the property must be acquired by purchase for use in the active conduct of a trade or business (section 1245 depreciable property). The total cost of the property expensed under this election cannot exceed the total amount of taxable income derived from the active conduct of any trade or business during the tax year. However, excess amounts may be carried forward an unlimited number of years, subject to the ceiling each year.

Wisconsin has not adopted the increased bonus depreciation and expensing provisions contained in the Job Creation and Worker Assistance Act of 2002 and the Jobs and Growth Tax Relief Reconciliation Act of 2003.

The fiscal effect of the accelerated depreciation exemption device relates to the revenue impact of allowing more generous depreciation write-offs in comparison to the allowable deductions under the straight-line depreciation method.

### **Dividends**

Dividends paid are generally not deductible by the payor corporation except for:

- Amounts paid as dividends or earnings to depositors' accounts by savings and loan associations, mutual loan corporations or mutual savings banks.
- Amounts distributed to patrons of businesses operating on a cooperative basis in proportion to their patronage, rather than stock or ownership. This type of dividend amounts to a delayed discount for purchases made.

Dividends received are deductible in full by the recipient corporation if the payor corporation is a controlled subsidiary in which the recipient parent corporation owns at least 70% of the voting stock. The payor corporation is not allowed to subtract the dividends paid in determining its Wisconsin taxable income.

### **Bad Debt Reserves of Financial Institutions**

In general, corporations can deduct bad debts only as the debts become worthless. Savings and loan associations, mutual savings banks, and other savings institutions may deduct additions to a reserve account for bad debts in lieu of deducting bad debts as they are experienced. Banks are also allowed to deduct additions to bad debt reserves, provided that the assets of the bank do not exceed \$500 million.

The deduction for additions to bad debt reserves is generally based on the average ratio of bad debts actually incurred to total loans outstanding for the five preceding taxable years. The tax benefit from this provision is that financial institutions using the reserve method can deduct bad debts before they actually become worthless.

### **Net Operating Loss Carryforward**

Wisconsin authorizes corporations to carry net operating losses incurred in the current year forward for up to 15 years to offset net income in future years. Federal law allows losses to be carried forward 20 years or carried back two years. This treatment acts to smooth out fluctuations in corporate profits, which may change dramatically with economic conditions. Similar to federal law, prior year losses must be applied against income to the maximum extent possible and in a consecutive fashion during the carryover period. Losses from the earliest years are always used first.

### **CREDITS**

A credit is an amount subtracted directly from the taxpayer's Wisconsin gross tax liability (i.e., the amount determined by applying the Wisconsin tax rate to Wisconsin taxable income) to determine the Wisconsin net tax liability. Generally, corporate tax credits are nonrefundable, that is, used only to reduce the amount of tax otherwise due.

### **Credit for Sales Tax on Fuel and Electricity Used in Manufacturing**

A nonrefundable credit can be claimed for the amount of Wisconsin sales tax paid on fuel and electricity consumed in manufacturing tangible personal property in the state. The credit is designed to be the equivalent of a sales tax exemption. Unused amounts of credit can be carried forward and offset against tax liability over the next 20 years. Corporations must increase their net income by the amount of credit claimed in lieu of reducing their deduction for the sales tax portion of the expense of fuel and electricity.

Fuel and electricity used in manufacturing will be exempt from the sales tax beginning in 2006 and the credit for sales tax will be repealed. In addition, manufacturers that meet certain conditions may continue to use manufacturers sales tax credit carried forward from prior years to offset income in the future. Manufacturers with up to \$25,000 of unused credit may take up to 50% in each of the following two years after the credit is repealed and the sales tax exemption takes effect. Manufacturers with more than \$25,000 of unused credit will be allowed to deduct unused credits over the next two years and will be eligible for the manufacturing investment credit, discussed below.

### **Manufacturing Investment Credit**

Beginning in 2008, businesses whose credit for sales tax on fuel and electricity used in manufacturing was disallowed after repeal of that credit in 2006 will be able to claim a manufacturing investment credit, provided they meet certain job retention, investment or other tests. The credit will equal the unused manufacturers' sales tax credit that disallowed, amortized over 15 years, with a 15-year carryforward of unused credits. The tests for eligibility for the credit include:

- Retention of 100% of the full-time (at least 35 hours per week) jobs employed by the company as of the effective date of the bill.
- Average annual investment since January 1, 2006, equal to 2% of total book value of the company's depreciable assets in Wisconsin-based plants and facilities or \$5 million.
- Other criteria specific to individual industries as determined by the Department of Commerce, in consultation with the Department of Revenue, through administrative rule.

### **Research Expenditures Credit**

A nonrefundable research expenditures credit for noncapital expenditures for research-related activities conducted in Wisconsin is available to corporations. The credit is patterned after the federal research credit and is equal to 5% of the excess of qualified research expenses for the current year over a base period amount. Qualifying expenditures are defined by reference to the rules established under Section 41 of the Internal Revenue Code. Expenses must be incurred in connection with research conducted in Wisconsin in order to qualify for the credit. The "base period amount" is calculated in the same manner as that for the federal credit, except that the gross receipts used in computing the state credit are from sales attributable to Wisconsin, other than throwback sales, for purposes of apportionment. Unused amounts of the credit can be carried forward for up to 15 years.

The credit applies only to research expenditures that are undertaken to discover information that is technological in nature and intended to be useful in the development of a new or improved business component. Qualified research expenses cover in-house expenses for the taxpayer's own research (wages, supplies and computer use charges) and 65% of amounts paid or incurred for qualified research done by a person other than an employee of the taxpayer.

### **Research Facilities Credit**

The research facilities credit applies to capital investments to construct and equip new research facilities or to expand existing facilities located in Wisconsin. The credit is equal to 5% of the amount of qualified investment in tangible depreciable property that is not replacement property.

The rules relating to the credit are similar to the rules for the research expenditures credit. The credit is nonrefundable, and unused amounts of credit may be carried forward and offset against tax liability over the next 15 years. Corporations must increase their net income by the amount of credit claimed in lieu of reducing their deduction for research expenses or reducing their basis in the property.

### Supplement to Federal Historic Rehabilitation Credit

A nonrefundable credit is available to encourage the rehabilitation of historic buildings in Wisconsin. The state supplemental credit is equal to 5% of qualified rehabilitation expenditures, as defined under Section 48 (g) of the Internal Revenue Code, to substantially rehabilitate certified historic buildings for use in a trade or business. This program is more fully discussed in the chapter on "Individual Income Tax."

### Development Zone, Development Opportunity Zone, Enterprise Development Zone, and Agricultural Development Zone Credits

Credits are available to corporate taxpayers who are certified by the Department of Development to participate in the Wisconsin development zone, development opportunity zone, enterprise development zone and agricultural development zone programs.

The *development zone program* provides credits to taxpayers that locate or expand a trade or business activity within a development zone. A development zone is an economically distressed area designated as a development zone by the Wisconsin Department of Commerce. Twenty-two zones have been designated, with authorized tax credits of \$38.155 million; these zone designations are in effect for a period of seven to ten years.

Certified businesses are provided with a maximum amount of tax benefits and may claim the development zone credits up to that amount.

Under the *development opportunity zone* program, corporations, except insurance companies, conducting economic activities in this type of zone may claim tax credits allocated to them. These zones have a duration of three years. Six zones with \$29.4 million in tax credits have been authorized.

*Enterprise development zones* are areas in which a single business is permitted to operate and receive tax credits. A business planning to conduct economic activity in a specific area of the state can apply with the Department of Commerce to have the area designated as an enterprise zone. Designation is based on criteria relating to high unemployment and poverty, declining property values and declining population, and is for a period of three years. The Department of Commerce has authority to designate up to 79 enterprise development zones; at least 10 of the zones must be for environmental remediation. Each zone is allocated a maximum of \$3 million credits, so that total credits under the program may total as much as \$237 million. Sixty-eight enterprise development zones have been authorized with \$125 million of credit allocated.

Beginning in 2003, the Department of Commerce may certify one zone as an *agricultural development zone*. The area must be located in a rural municipality and the zone designation will be in effect for ten years. The area may be certified for up to \$5 million of credits.

The credit for creation or retention of full-time jobs and for environmental remediation in a zone is comprised of the following components:

- Up to \$8,000 for each full-time job created or retained by a member of a target group;
- Up to \$6,000 for each full-time job created or retained and filled by a person who is not a member of a target group; and
- Up to 50% of amounts spent for environmental remediation.

A member of a target group includes a person employed in unsubsidized or trial jobs under the Wisconsin Works program, a person qualifying for the Wisconsin Works health plan or child assistance, a vocational rehabilitation referral, an economically disadvantaged veteran, an economically disadvantaged ex-convict, a social security insurance recipient, a food stamp recipient, or a dislocated worker.

In addition, an investment credit is available to taxpayers in a development opportunity zone. The credit equals 2.5% of the purchase of depreciable tangible personal property (1.75% of the price if the property has been expensed under section 179 of the Internal Revenue Code). A 3% capital investment credit is also available to taxpayers in development opportunity zones located in Milwaukee and Beloit and in an agricultural zone.

### **Technology Zone Credit**

A credit is available for businesses certified by the Department of Commerce and located in a technology zone. Commerce may certify up to eight technology zones, each for up to \$5 million in credits. All eight zones have been designated.

The credit has the following components:

- The amount of real and personal property taxes imposed and paid in the taxable year,
- 15% of the first twelve months of wages for jobs created in a technology zone after certification.
- 10% of certain capital investments made in a technology zone in the year.

Sixteen businesses have been certified for \$2.5 million.

### **Dairy Investment Credit**

For taxable years beginning after 2003 and before 2010, a credit is available for 10% of certain expenditures to modernize or expand a dairy or heifer farm.

### **Early Stage Seed Investment Credit**

Effective for taxable years beginning after 2004, an early stage seed investment credit is available for 25% of investments in qualified new business ventures that are certified by the Department of Commerce. To be eligible for credit, a qualified new business venture must meet certain requirements, including that it have its headquarters in the state, have less than 100 employees, at least 51% of whom are employed in the state, and have been in business for not more than seven consecutive years. A qualified new business venture must also be engaged in certain industries: manufacturing, agriculture, processing or assembling products, conducting research and development or developing new products or business processes. The total amount of credits that may be claimed is \$3.5 million per taxable year and \$35 million for all taxable years.

### **Farmland Tax Relief Credit**

A farmland tax relief credit equal to a percentage, established by the Department of Revenue, of property taxes up to \$10,000 on farmland, exclusive of improvements, is allowed for owners of farmland. This credit is refundable. The credit percentage is set so that the amount expended for the credit for all claimants, individual and corporate, is \$15 million, adjusted for underspending or excess spending in the prior fiscal year. For tax year 2003, the percentage was 16%. This estimate represents claims by corporate taxpayers. The credit is described in greater detail in the Individual Income Tax chapter.

### **Farmland Preservation Credit**

Corporations are eligible for Farmland Preservation Credits and must meet basically the same requirements as individual taxpayers (see Individual Income Tax chapter). Household income for corporations is defined as the sum of net corporate income, any business loss carryforward allowed under section 71.26 (4), Wis. Stats., and the household income of each corporate shareholder including the income of spouse, dependents and other members of the household. Corporations must include in their household income farm depreciation in excess of \$25,000, all nonfarm depreciation and nonfarm business losses. The credit is refundable.

### **Investments in the Community Development Finance Company**

A credit is allowed for capital investments in the Wisconsin Community Development Finance Company. Eligibility for the credit is restricted to taxpayers who have made a contribution to the Community Development Finance Authority (CDFA). The credit is equal to 75% of the cost of common stock or a partnership interest purchased in the Community Development Finance Company. The base for computing the credit is limited to the value of the claimant's contribution to the CDFA.

The credit is nonrefundable and unused amounts of credit can be carried forward and offset against tax liability over the next 15 years. Taxpayers must increase their income by the amount of the credit claimed in lieu of reducing their deduction for the contribution to the CDFA.

The CDFA was repealed by 1987 Wisconsin Act 399. Beginning in 1988, the credit applies to capital investments in the Wisconsin Housing and Economic Development Authority (WHEDA).

### **Insurance Security Fund Assessments**

Chapter 646, Wisconsin Statutes, provides a credit against state taxes, including the corporate income and franchise tax, for certain assessments levied on insurance companies by the Wisconsin Insurance Security Fund. The fund is designed to protect policyholders in cases where their insurance company has failed and is in the process of liquidation. Where the available assets and reserves of failed insurers are inadequate to meet claims, the fund may assess insurance companies doing business in the state, with some exceptions (e.g., fraternal benefit societies). Such assessments are eligible for a 100% tax credit if they cannot be recovered through higher premiums. This can occur where premiums are fixed on a particular line of business. Credits claimed by foreign insurance companies and domestic life companies would be offset against the premiums tax. Thus, the only offsets against the income and franchise tax would be for credits claimed by domestic property and casualty companies. The tax credit is nonrefundable and must be claimed in equal installments over a five-year period, beginning with the year following the one in which the assessment is made.

## RECYCLING SURCHARGE

### Introduction

Effective for tax years beginning on or after January 1, 2000, Wisconsin imposes a recycling surcharge on all non-farm businesses with gross receipts of at least \$4 million. The surcharge is imposed at a rate of 3% on gross tax liability for corporations and 0.2% of net business income for noncorporate business entities. The maximum surcharge is \$9,800 and the minimum is \$25. Noncorporate farms are exempt from the surcharge if their gross receipts from farming are no more than \$4,000,000; they pay a surcharge of \$25 if not exempt. The surcharge does not apply to entities not required to file an income tax return.

Revenues from the recycling surcharge are deposited in the segregated recycling fund, and used to fund local government recycling and solid waste management programs and private business efforts to develop recycled products or markets related to these products. Collections for FY04 were \$25.5 million. However, the collection amount overstates recycling revenue from the fee because a \$6.2 million transfer from the recycling fund to the general fund to reverse a previous transfer of estimated payments was not made as scheduled before the end of the fiscal year.

**TABLE 1**  
**RECYCLING SURCHARGE EXEMPTION DEVICES SUMMARY**

Exemption Devices	Statutory Reference*	FY04 Fiscal Effect
<b>Exemptions from Taxation</b>		
Exempt Corporations	s 77.93 (1)	Not available
Exempt Individuals, Estates and Trusts	s 77.93 (2)	Not available
\$4 Million Gross Receipts Exemption	s 77.93 (1) and 77.94 (1)(b)	\$16,000,000
Members of the Clergy and Certain Religious Groups	s 77.92 (5)	Minimal
<b>Special Treatment</b>		
\$9,800 Surcharge Limit	s 77.94 (1)	\$9,000,000
Farming Surcharge of \$25	s 77.94 (1)	Minimal

\* References to sections of the 2003 Wisconsin Statutes.

### EXEMPTIONS FROM TAXATION

#### Exempt Corporations

Corporations that are exempt from the corporate income and franchise tax under sec. 71.26 (1), Wis. Stats., and that have no unrelated business income reportable under sec. 71.24 (1m), Wis. Stats., are exempt from the surcharge. This exemption applies to not-for-profit entities.

#### Exempt Individuals, Estates and Trusts

The surcharge does not apply to natural persons, estates or trusts that are not required to file a return because their income is less than the filing requirements under Subchapter I or II of Chapter 71, Wis. Stats. Of those filing, also exempt are persons who are not employees as defined in section 3121 (d)(3) of the Internal Revenue Code or not filing a form indicating a profit or loss from a trade or business for federal income tax purposes.

#### \$4 Million Gross Receipts Exemption

Businesses with less than \$4 million of gross receipts are exempt from the surcharge.

#### Members of the Clergy and Certain Religious Groups

Members of the clergy and members of certain recognized religious groups who perform services or duties as defined by section 1402 (c)(4) and (5) of the Internal Revenue Code are exempt from the temporary recycling surcharge.

## **SPECIAL TREATMENT**

### **\$9,800 Surcharge Limit**

The maximum surcharge that any taxpayer will pay is limited to \$9,800. This is considered an exemption device because the amount of surcharge that is collected is less than it would be had the surcharge been collected under the existing rates without the maximum.

### **Farming Surcharge of \$25**

All natural persons, estates, trusts, partnerships, and limited liability companies that are engaged in farming, except entities that have gross receipts from farming of no more than \$4 million, are subject to a surcharge of \$25 regardless of the amount of net farm profit. It is believed that very few noncorporate farms have gross receipts of at least \$4 million and are subject to the surcharge.

## SALES AND USE TAX

### Introduction

Wisconsin imposes a 5% tax on the sale or use of most items of tangible personal property and on selected services. The state first imposed a 3% selective sales and use tax in 1962 but replaced it with a 4% general sales and use tax in 1969. The current 5% rate has been in effect since 1982.

The original 3% tax was selective in that goods subject to the tax were specifically identified in the statutes: household furnishings, motor vehicles, jewelry, tobacco, fermented malt beverages, intoxicating liquors and food sold in restaurants. The general tax imposed in 1969, in contrast to the selective tax, falls on sales of all tangible personal property, except property specifically exempted by law. The sales tax remains selective in its treatment of services, imposed only on those services specifically identified as taxable in the statutes.

Numerous changes to the sales tax base have been made over the years. Exemptions are discussed in detail in the latter half of this chapter and estimates of fiscal effects are provided. Expansions of the sales and use tax base include:

- Cigarettes (1975);
- Cable television, including installation (1975);
- Interstate telephone and telegraph services, and landscaping and lawn maintenance services (1982);
- Magazines other than those sold by subscription (1983);
- Telephone company central office equipment and coin-operated telephone services (1996);
- Telephone answering and messaging services, and telecommunications services terminating in and billed to a service address in the state (1997).

The 5% sales tax is imposed on retailers for the privilege of selling, leasing or renting tangible personal property that is not specifically exempt from tax. In addition, a 5% use tax is imposed on the storage, use or other consumption in this state of tangible personal property that is purchased out-of-state and is not specifically exempt. The use tax complements the sales tax in that, without a use tax, consumers would be able to avoid sales tax by purchasing goods out-of-state. Thus, the use tax ensures that the sales tax does not place Wisconsin merchants at a competitive disadvantage compared with those in other states.

### Taxable Services

The law imposes a sales tax on selected services. Unlike tangible personal property, sales of which are taxable unless specifically exempt, services are not subject to the sales tax unless specifically identified in the statutes. The following services are taxable:

- Rooms or lodging for less than one-month by hotelkeepers, motel operators and other persons furnishing accommodations to the public.
- Admissions to amusement, athletic, entertainment or recreational events or places. Admissions to places or events considered educational in nature, such as museums or zoos, and admissions to county fairs are exempt from sales tax.
- Telecommunications services originating or terminating in Wisconsin and charged to a service address in the state, including coin-operated telephone services. Prepaid telephone cards or authorization numbers are taxed at the time of purchase; services obtained through the use of cards or authorization numbers are not taxable.

- Laundry, dry cleaning, pressing and dyeing services, except when performed on raw materials, on goods in process or on cloth diapers by a diaper service, and except when performed by the customer through the use of coin-operated, self-service machines.
- Photographic services, including the processing, printing and enlarging of film, and the services of photographers for the taking, reproducing and sale of photographs.
- Parking or providing parking space for motor vehicles and aircraft, and docking or providing storage space for boats.
- The repair, inspection and maintenance of tangible personal property, and the installation of tangible personal property, except when such installation constitutes a capital improvement.
- The production, printing or imprinting of tangible personal property for consumers who furnish directly or indirectly the materials used in such processes.
- Cable television services, including installation charges.
- Landscaping and lawn maintenance services.
- Telephone answering and messaging services.

### Local Taxes

The law allows counties and professional football stadium districts to impose a 0.5% local sales and use tax and professional baseball park districts to impose a 0.1% sales and use tax. These local taxes are imposed on the same tax base as the state sales tax. As of January 1, 2004, 58 counties impose the 0.5% county sales tax.

The Southeast Wisconsin Professional Baseball Park District imposed a 0.1% sales tax in Milwaukee, Ozaukee, Racine, Washington and Waukesha Counties in 1996. Proceeds from this tax are used to finance Miller Park, the Milwaukee Brewers' home field. This tax will be discontinued upon retirement of the bonds issued to finance the ballpark and the funding of a maintenance and capital improvement fund for the ballpark.

The Green Bay-Brown County Professional Football Stadium District imposed a 0.5% sales tax in Brown County in 2000 to finance renovation of Lambeau Field. This tax will be discontinued upon retirement of the bonds issued to finance the stadium and the funding of a maintenance and capital improvement fund for the stadium.

Table 1 lists the state's 72 counties, the local sales taxes applicable in each county, the effective date of the county sales tax, and the combined state and local sales tax rate.

### Administration and Collections

Sales tax is imposed on the gross receipts from retail sales; use tax is imposed on the amount paid for a good. Each retailer is responsible for paying sales tax, regardless of whether it is identified on the bill and collected directly from the customer. Every business that makes taxable sales is required to obtain a seller's permit from the department and pay a \$20 business tax registration fee, which covers permits for other taxes.

Retailers are permitted to retain a portion of the taxes they collect as compensation for the costs they incur in collecting the tax. Since 1997 the retailer's discount has been 0.5% of the amount of tax liability if taxes are paid timely, with a minimum discount of \$10 per filing period. Retailers file monthly, quarterly or annually, depending on the amount of tax owed.

In contrast to the sales tax which is paid by the seller, use tax is paid by the purchaser. Corporations may file a use tax return or report use tax on their corporate income and franchise tax returns. Private individuals indicate their use tax liability on their individual income tax returns.

**TABLE 1**  
**LOCAL SALES AND USE TAXES AND COMBINED STATE-LOCAL TAX RATE BY COUNTY**  
**JANUARY 1, 2004**

County	Local Taxes (Effective Date)	Combined State-Local Tax Rate	County	Local Taxes (Effective Date)	Combined State-Local Tax Rate
Adams	County (1/1/94)	5.5%	Marathon	County (4/1/87)	5.5%
Ashland	County (4/1/88)	5.5%	Marinette	County (10/1/01)	5.5%
Barron	County (4/1/86)	5.5%	Marquette	County (4/1/89)	5.5%
Bayfield	County (4/1/91)	5.5%	Menominee	None	5.0%
Brown	Football Stadium	5.5%	Milwaukee	County (4/1/91), Ballpark	5.6%
Buffalo	County (4/1/87)	5.5%	Monroe	County (4/1/90)	5.5%
Burnett	County (4/1/89)	5.5%	Oconto	County (7/1/94)	5.5%
Calumet	None	5.0%	Oneida	County (4/1/87)	5.5%
Chippewa	County (4/1/91)	5.5%	Outagamie	None	5.0%
Clark	None	5.0%	Ozaukee	County (4/1/91), Ballpark	5.6%
Columbia	County (4/1/89)	5.5%	Pepin	County (4/1/91)	5.5%
Crawford	County (4/1/91)	5.5%	Pierce	County (4/1/88)	5.5%
Dane	County (4/1/91)	5.5%	Polk	County (4/1/88)	5.5%
Dodge	County (4/1/94)	5.5%	Portage	County (4/1/89)	5.5%
Door	County (4/1/88)	5.5%	Price	County (1/1/93)	5.5%
Douglas	County (4/1/91)	5.5%	Racine	Ballpark	5.1%
Dunn	County (4/1/86)	5.5%	Richland	County (4/1/89)	5.5%
Eau Claire	County (1/1/99)	5.5%	Rock	None	5.0%
Florence	None	5.0%	Rusk	County (4/1/87)	5.5%
Fond du Lac	None	5.0%	St. Croix	County (4/1/87)	5.5%
Forest	County (4/1/95)	5.5%	Sauk	County (4/1/92)	5.5%
Grant	County (4/1/02)	5.5%	Sawyer	County (4/1/87)	5.5%
Green	County (1/1/03)	5.5%	Shawano	County (4/1/90)	5.5%
Green Lake	County (7/1/99)	5.5%	Sheboygan	None	5.0%
Iowa	County (4/1/87)	5.5%	Taylor	County (7/1/99)	5.5%
Iron	County (4/1/91)	5.5%	Trempealeau	County (10/1/95)	5.5%
Jackson	County (4/1/87)	5.5%	Vernon	County (1/1/97)	5.5%
Jefferson	County (4/1/91)	5.5%	Vilas	County (4/1/88)	5.5%
Juneau	County (4/1/92)	5.5%	Walworth	County (4/1/87)	5.5%
Kenosha	County (4/1/91)	5.5%	Washburn	County (4/1/91)	5.5%
Kewaunee	None	5.0%	Washington	County (1/1/99), Ballpark	5.6%
LaCrosse	County (4/1/90)	5.5%	Waukesha	Ballpark	5.1%
Lafayette	County (4/1/01)	5.5%	Waupaca	County (4/1/89)	5.5%
Langlade	County (4/1/88)	5.5%	Waushara	County (4/1/90)	5.5%
Lincoln	County (4/1/87)	5.5%	Winnebago	None	5.0%
Manitowoc	None	5.0%	Wood	County (1/1/04)	5.5%

Collections of sales and use taxes have increased as the economy has grown and Wisconsin personal incomes have increased. In addition, the state tax rate was increased in 1969 to 4% and to 5% in 1982 and the tax base has been changed. Collections have increased from \$83 million in FY65 to \$3,899 million in FY04. Sales and use taxes provided 14% of general purpose tax revenues in FY65, but that share had risen to about 36% in FY04.

Table 2 shows the source of sales taxes by type of business. In calendar year 2003, over 61% of sales taxes were collected from businesses engaged in retail trade while service industries accounted for 12.9%.

**TABLE 2  
WISCONSIN SALES AND USE TAXES BY NAICS, 2003**

NAICS	Descriptions	Filers	Total Taxes
11	Agricultural, Forestry, Hunting, & Fishing	603	\$3,350,178
233, 235	Construction	4,698	86,430,762
221, 454	Utilities & Other Fuel Dealers	253	223,116,983
	SUBTOTAL: INFORMATION & COMMUNICATIONS	1,762	\$235,083,948
511	Publishing	679	14,748,500
512	Motion Picture, Video, & Sound Industries	107	2,101,282
513, 5141	Broadcasting, Telecommunications & Information Services	976	218,234,165
	SUBTOTAL: MANUFACTURING	6,228	\$129,651,935
311, 312	Food, Beverage & Tobacco Manufacturing	165	3,460,284
21, 32	Raw Materials Manufacturing, including Quarrying	1,027	27,352,974
324-327	Chemical & Nonmetallic Mineral Product Manufacturing	377	13,804,178
33	Mechanical, Machinery, Industrial & Other Manufacturing	4,659	85,034,499
	SUBTOTAL: RETAIL	75,687	\$2,264,309,318
722	Food Services & Drinking Places (Restaurants & Bars)	13,773	284,847,929
711	Performing Arts, Spectator Sports & Related Industries	665	17,232,242
713	Amusement, Gambling, Recreation Industries	1,289	19,466,759
441	Automobiles & Other Motor Vehicles	4,023	480,821,795
447100	Gasoline Stations (including convenience stores with gas)	1,744	57,313,320
448	Clothing & Accessories Stores	2,556	116,107,179
443	Electronic & Appliance Stores	1,171	70,407,692
445	Food & Beverage Stores	3,205	168,139,630
442, 444	Furniture & Home Furnishings Stores	5,349	290,207,367
446	Health & Personal Care Stores	597	30,275,982
451	Sporting Goods, Hobby, Book, & Music Stores	3,343	52,156,251
452, 453	General Merchandise Stores	1,311	362,001,271
453 et al.	Other Store Retailers	33,594	288,745,988
453, 454	Nonstore Retailers	3,067	26,585,910
	SUBTOTAL: SERVICES	47,092	\$479,229,026
721	Hotels, Motels & Other Traveler Accommodations	3,730	65,960,389
52, 55	Banking, Insurance and Other Finance Activities	674	15,645,939
561	Administrative & Support Services	1,160	18,063,768
62	Health Care and Social Assistance Services	1,908	6,203,623
812	Personal & Household Services	14,350	93,985,253
Various	Business Services	8,739	77,398,591
811	Repair & Maintenance Services	8,527	68,200,148
5411, 5412	Professional Services	455	716,274
5413	Architectural, Engineering, & Related Services	163	901,320
5415	Computer System Services	2,433	38,854,798
54	Scientific & Other Services	641	5,711,627
532	Rental & Leasing Services	3,739	85,090,313
531	Real Estate Services (Rental, Management, Appraisal)	573	2,496,982
	SUBTOTAL: WHOLESALE	4,596	\$180,170,616
421	Durable Goods - Wholesale	3,142	160,745,612
422	Nondurable Goods - Wholesale	1,454	19,425,004
	MISCELLANEOUS	2866	\$102,134,584
48	Transportation	434	5,442,524
	Miscellaneous & Unclassified	2,432	96,692,060
	TOTAL	143,785	\$3,703,477,348

### Calculations of Exemptions

This report describes each sales tax exemption and, where feasible, provides an estimate of its fiscal effect in FY04. In general, fiscal effects were estimated by obtaining or estimating the gross receipts from retail sales for the most recent year available and adjusting those receipts to FY04 levels using income and price data. When possible, state-specific data from state and federal agencies and trade organizations with statewide membership or information were used. For some exemptions, state receipts were not available, but were estimated from national sales data using the Wisconsin share of the nation's population, personal income or a similar indicator. For some exemptions, data on which to base an estimate are not available. For others, no estimate is made because the state is precluded from taxing the sale — for example, sales to the federal government, which are exempt under the U.S. Constitution.

The significance of these exemptions may be viewed from the perspective of sales and use tax collections, which were \$3,899 million in FY04. Thus, the exemption for food, which is estimated to cost \$505 million in foregone tax revenues, represents 13.0% of FY04 sales and use tax collections.

**TABLE 3**  
**SALES AND USE TAX EXEMPTION DEVICES SUMMARY**

Exemption	Statutory Reference*	FY04 Fiscal Effect
<b>Exemptions for Property Sold Primarily to Households</b>		
Food	s. 77.54 (20) and (20m)	\$505,000,000
Meals Furnished by Institutions of Higher Education	s. 77.54 (20)(c)5	3,700,000
Water Sold Through Mains	s. 77.54 (17)	17,500,000
Fuel and Electricity for Residential Use	ss. 77.54 (30)(a)1 and 2	112,200,000
Manufactured Homes and Mobile Homes Used as Primary Housing	ss. 77.51 (4)(b) 6 and 7, (15)(b)5 and 6, 77.54 (31)	4,200,000
Motor Fuels	s. 77.54 (11)	278,000,000
Newspapers, Periodicals and Shoppers Guides	s. 77.54 (15)	11,500,000
Caskets and Burial Vaults	s. 77.54 (21)	3,500,000
U.S. and State of Wisconsin Flags	s. 77.54 (46)	Minimal
Coin-Operated Laundry and Dry Cleaning Services	s. 77.52 (2)(a)6	3,300,000
Cloth Diapers and Diaper Services	ss. 77.51 (1m) and (3m), 77.52 (2)(a)6 and 77.54 (40)	40,000
<b>Exemptions Related to Health Care</b>		
Prescription Drugs and Medicines (excluding Insulin)	s. 77.54 (14)	119,400,000
Insulin and Equipment Used in the Treatment and Testing of Diabetes	ss. 77.54 (14m) and (28)	12,400,000
Medical Devices (including Wheelchairs, Home Oxygen Equipment)	ss. 77.54 (14s) and (22)	11,000,000
Meals Provided by Nursing Homes, Community-Based Residential Facilities and Hospitals, and Food Sold in Retirement Homes	s. 77.54 (20)(c)4	Not available
<b>Exemptions Related to Farming</b>		
Tractors and Farm Machinery	s. 77.54 (3)	20,800,000
Personal Property and Supplies Used in Farming	s. 77.54 (3m)	77,000,000
Electricity Used in Farming	s. 77.54 (30)(a)3	7,000,000
Fuel Used in Farming	s. 77.54 (30)(a)5	7,000,000
Veterinary Services and Medicines for Farm Livestock	ss. 77.52 (2)(a)10 and 77.54 (33)	5,600,000
Semen for Livestock Breeding	s. 77.54 (27)	2,400,000
Milkhouse Supplies	s. 77.54 (34)	5,300,000
<b>Exemptions Related to General Business</b>		
Machinery and Equipment Used in Manufacturing	ss. 77.54 (5)(d) and (6)(a)	158,600,000
Fuel and Electricity Used in Manufacturing (beginning 1/1/06)	s. 77.54 (30)(a)6	None
Tangible Personal Property Consumed in Manufacturing	s. 77.54 (2)	Not available
Component Parts of Shoppers Guides, Newspapers and Periodicals	s. 77.54 (2m)	Not available

**TABLE 3**  
**SALES AND USE TAX EXEMPTION DEVICES SUMMARY, continued**

Exemption	Statutory Reference*	FY04 Fiscal Effect
<b>Exemptions Related to General Business, continued</b>		
Fuels Converted to Electric Energy, Gas or Steam by Utilities	s. 77.54 (6)(c)	Not available
Waste Treatment Facilities and Machinery and Equipment Used in Recycling	s. 77.54 (5)(c), (26) and (26m)	15,000,000
Logging Equipment	s. 77.54 (39)	400,000
Equipment Used in the Production of Maple Syrup	s. 77.54 (29)	Minimal
Wood Residue Used as Fuel in a Business Activity	s. 77.54 (30)(a)4	170,000
Building Materials, Equipment and Supplies Used in the Construction of Professional Sports Stadiums	s. 77.54 (41)	Not available
Live Game Birds and Clay Pigeons	s. 77.54 (47)	2,500,000
Trucks, Tractors, Buses and Other Vehicles Sold to Common or Contract Carriers	s. 77.54 (5)(b)	24,200,000
Rolling Stock Used in Railroad Operations	s. 77.54 (12)	4,500,000
Commercial Vessels and Barges	s. 77.54 (13)	2,500,000
Containers, Labels, Sacks, Cans, Boxes and Other Packaging and Shipping Materials	s. 77.54 (6)(b)	Not available
Motion Picture and TV Film and Advertising Materials	s. 77.54 (23m)	9,600,000
Restaurant Employee Meals	s. 77.54 (20)(c)4m	Not available
Tangible Personal Property Purchased for Resale but Donated to a Nonprofit Organization	s. 77.56 (3)	Not available
Prepaid Telephone Cards and Authorization Numbers	s. 77.54 (46m)	Minimal
<b>Exemptions for Government Agencies and Nonprofit Organizations</b>		
Sales to the Federal Government and Its Agencies	s. 77.55 (1)	Not available
Sales to State and Local Governments and Schools	s. 77.54 (9a)(a) to (em), (g) and (h)	228,000,000
Religious, Charitable, Scientific and Educational Organizations	s. 77.54 (9a)(f)	113,000,000
Lunches and Other Tangible Personal Property Sold by Elementary and Secondary Schools	s. 77.54 (4)	9,500,000
Admissions to Elementary and Secondary School Activities	s. 77.54 (9)	700,000
Admissions to State Parks and Camping Fees	s. 77.54 (10)	600,000
Admissions to Certain Historical Museums	s. 77.54 (10)	29,000
Admissions to County Fairs	s. 77.52 (2)(a)2	Not available
Volunteer Fire Department Equipment	s. 77.54 (16)	Minimal
Copies of Public Records	s. 77.54 (32)	Minimal
Sales by American Legion Baseball Teams	s. 77.54 (35)	Not available
Snowmobile Trail Grooming Equipment	s. 77.54 (38)	Minimal
Charges for Emergency Telephone Systems	ss. 77.51 (15)(b)7, 77.54 (37)	500,000
Sales of Animal Identification Tags and Samples by the Department of Agriculture, Trade and Consumer Protection	s. 77.54 (42)	17,000
Public Benefits Fees	s. 77.54 (44)	5,100,000
One-time License or Right to Purchase Admissions to Professional Football Games	s. 77.54 (45)	30,000
Motor Vehicles Loaned to Driver Education Programs	s. 77.56 (2)	Minimal
<b>Exemptions for Nonresidents and for Use in Other States</b>		
Interstate Commerce	s. 77.54 (1)	Not available
Property Used in Wisconsin by Nonresidents	s. 77.53 (17)	Not available
Nonresidents' Boats Berthed in Boundary Waters	s. 77.53 (17m)	Not available
Nonresidents' Aircraft Hangared in Wisconsin	s. 77.53 (17r)	Not available
Goods Brought into the State by New Residents	s. 77.53 (18)	Not available

**TABLE 3**  
**SALES AND USE TAX EXEMPTION DEVICES SUMMARY, continued**

Exemption	Statutory Reference*	FY04 Fiscal Effect
<b>Exemptions for Nonresidents and for Use in Other States, continued</b>		
Property Purchased for Use Outside the State	s. 77.55 (3)	Not available
Aircraft, Motor Vehicles and Truck Bodies Sold for Use Outside the State	s. 77.54 (5)(a)	Not available
Property Sold to Out-of-State Common or Contract Carriers	ss. 77.55 (2) and (2m)	Not available
Printed Advertising Material Used Outside the State	s. 77.54 (25)	Not available
Temporary Storage of Printed Materials	s. 77.54 (43)	Not available
<b>Definitional and Miscellaneous Exemptions</b>		
Exemptions That Further Define Retail Sales	See text	Not available
Labor Input into Construction	ss. 77.51 (4)(c)4 and 77.52 (2)(a)10	580,000,000
Trade-Ins and Lemon Law Refunds	s. 77.51 (4) (b)3 and 3m and (15)(b)4 and 4m	133,000,000
Transportation Charges	s. 77.51 (4)(b)5 and (15)(b)3	Not available
Occasional Sales	s. 77.54 (7) and (7m)	Not available
Auction Sales	s. 77.51 (9)(e)	Not available
Retailer's Discount	s. 77.61 (4)(c)	22,700,000

\* References are to the 2003 Wisconsin Statutes.

## **EXEMPTIONS FOR PROPERTY SOLD PRIMARILY TO HOUSEHOLDS**

### **Food for Home Consumption**

Sales of food, food products and beverages purchased for home consumption are exempt from sales tax. However, items such as candy, soda water beverages, beer, wine and liquor are taxable. Sales from vending machines of food, food products and beverages are treated as sales for home consumption. When exempt food items are packaged with taxable items, the package is exempt if at least 50% of the price is attributable to the exempt items. Meals sold in restaurants, cafes and cafeterias are taxable.

### **Meals Furnished by Institutions of Higher Education**

Sales of meals, food and beverages furnished by public and private institutions of higher education are exempt from sales tax if they are furnished to students in that institution or under an agreement with a National Football League team.

### **Water Sold Through Mains**

Sales of water delivered through mains, and sales of water by public and private water utility districts are exempt from the sales tax.

### **Fuel and Electricity for Residential Use**

All sales for residential use of coal, fuel oil, propane, steam, peat, fuel cubes produced from solid waste and sales of wood used for fuel for residential use are exempt from sales tax. Sales of electricity and natural gas for residential use billed from November through April are also exempt from sales tax.

### **Manufactured Homes and Mobile Homes Used as Primary Housing**

Thirty-five percent of the sales price of a new mobile home used as primary housing is exempt from sales tax if the home is at least 45 feet in length, or is transported in two sections with a total area of 984 square feet. Sales of used mobile homes used as primary housing and meeting the size requirements are fully exempt. A portion of the sales price of a manufactured home, equal to either 35% of the price or the gross receipts less the amount attributable to materials, is also exempt.

**Motor Fuels**

Sales of motor fuels that are subject to the state motor fuel excise tax are exempt from the sales tax. Exempt fuels include gasoline, commercial and general aviation fuel and diesel fuel.

**Newspapers, Periodicals and Shoppers Guides**

Sales of newspapers, periodicals sold by subscription, and shoppers guides that distribute at least 48 issues in a 12-month period are exempt from sales tax. The exemption for newspapers and periodicals is generally limited to those published four or more times per year; periodicals issued at intervals not exceeding six months by an educational association or tax-exempt religious, charitable, scientific or educational organization are also exempt.

**Caskets and Burial Vaults**

Sales of caskets and burial vaults are exempt from the sales tax.

**United States of America and State of Wisconsin Flags**

Sales of U.S. and Wisconsin flags are exempt from the sales tax.

**Coin-Operated Laundry and Dry Cleaning Services**

Laundry services performed by customers using coin-operated equipment are exempt. Gross receipts from laundry, dry cleaning, pressing and dyeing services performed on raw materials in process and destined for sale are also exempt.

**Cloth Diapers and Diaper Services**

Gross receipts from the sale or rental of cloth diapers and gross receipts of diaper services are exempt.

**EXEMPTIONS RELATED TO HEALTH CARE****Prescription Drugs and Medicines**

Sales of medicines are exempt from sales and use tax if the medicines are: (1) prescribed for treatment by an authorized person or dispensed by a registered pharmacist; (2) furnished by a licensed physician, surgeon, podiatrist or dentist to his own patient; (3) furnished by a hospital for treatment of patients on the orders of a licensed physician, surgeon, podiatrist or dentist; (4) sold to a licensed physician, surgeon, podiatrist or dentist for treatment of patients; (5) sold to this state or a political subdivision or any municipal corporation thereof for use in treatment of human beings or furnished by a medical facility maintained by the state; (6) furnished for the treatment of a human being by a medical facility or clinic maintained by the state or a political subdivision or any municipal corporation thereof, or (7) furnished without charge to a physician, surgeon, nurse anesthetist, advanced practical nurse, osteopath, dentist, podiatrist or optometrist if the medicine may not be dispensed without a prescription.

**Insulin and Equipment Used in the Treatment and Testing of Diabetes**

Insulin and apparatus used for the injection of insulin, other equipment used to treat diabetes, and equipment and supplies used to measure blood sugar levels are exempt from the sales tax.

**Medical Devices**

Medical devices, including repair parts and accessories, are exempt from sales tax. Exempt devices include wheelchairs and crutches; artificial limbs, eyes and teeth; prescription eye glasses; hearing aids; equipment used to administer prescription oxygen; prescription antiembolism hose and stockings; and adaptive equipment to enable a handicapped person to enter, operate and leave a motor vehicle.

**Meals Provided by Nursing Homes, Community-Based Residential Facilities and Hospitals, and Food Sold in Retirement Homes**

Sales of meals and food by, and served on the premises of, hospitals, sanatoriums, nursing homes, community-based residential facilities, day care centers and retirement homes are exempt from the sales tax. Retirement homes are nonprofit residential facilities where three or more unrelated adults or their spouses have their principal residence and where support services, including meals from a common kitchen, are available to residents. Most meals provided by these institutions are included in the daily room charge and an estimate of the food component is not feasible.

**EXEMPTIONS RELATED TO FARMING****Tractors and Farm Machinery**

Sales of tractors and farm machinery, including accessories, attachments, and parts, used directly in farming are exempt from sales tax. The exemption does not apply to motor vehicles for highway use, such as cars and trucks.

**Personal Property and Supplies Used in Farming**

Sales of seeds; plants; feed; fertilizer; soil conditioners; animal bedding; sprays, pesticides, and fungicides; breeding and other livestock; farm work stock; baling twine and baling wire; containers; and plastic bags, sleeves, and sheeting used to store or cover hay or silage are exempt from sales tax.

**Electricity Used in Farming**

Electricity sold for use in farming is exempt from sales tax.

**Fuel Used in Farming**

Fuel sold for use in farming is exempt from sales tax.

**Veterinary Services and Medicines for Farm Livestock**

Sales of services provided by veterinarians for animal health care, breeding or training of livestock, and sales of medicines used to treat farm livestock, are exempt from sales tax.

**Semen for Livestock Breeding**

The sale of semen used for the artificial insemination of livestock is exempt from sales tax.

**Milkhouse Supplies**

Sales of milkhouse supplies used exclusively in producing and handling milk on dairy farms are exempt from sales tax.

**EXEMPTIONS RELATED TO GENERAL BUSINESS****Machinery and Equipment Used in Manufacturing**

The sale and use of machinery, processing equipment and repair parts used exclusively and directly by a manufacturer in the manufacturing process are exempt from the sales tax. Generally, manufacturing is defined as the production by machinery from existing materials of a new article of tangible personal property with a different form, use or name. Mobile mixing and processing units, including the vehicles on which they are mounted, are also exempt manufacturing machinery and equipment.

**Fuel and Electricity Used in Manufacturing**

Fuel and electricity used in manufacturing tangible personal property will be exempt from the sales tax, beginning January 1, 2006.

**Tangible Personal Property Consumed in Manufacturing**

Tangible personal property (i.e., raw materials) that is consumed, destroyed or loses its identity in the manufacturing process of finished goods is exempt from sales tax.

**Component Parts of Shoppers Guides, Newspapers and Periodicals**

Materials and services that become component parts of shoppers guides, newspapers and periodicals are exempt from sales tax.

**Fuels Converted to Electric Energy, Gas or Steam by Utilities**

All fuels converted to electric energy, gas or steam by utilities are exempt from sales tax.

**Waste Treatment Facilities and Machinery and Equipment Used in Recycling**

Sales and installation of waste treatment (pollution control) facilities, replacement parts, and chemicals and supplies used in operating a waste treatment facility are exempt from the sales tax. The exemption applies to expenditures by governmental units, private industry and their construction contractors for sewage treatment plants, holding ponds and similar facilities. The sale and use of machinery and equipment and repair parts used exclusively and directly for waste reduction or recycling activities are exempt. Also exempt are motor vehicles used exclusively and directly in recycling that are not required to be licensed for highway use. The activities qualifying for the exemption include those that reduce the amount of solid waste generated, recover energy from solid waste, and reuse, recycle, or compost solid waste. Some recycling machinery is also exempt as manufacturing machinery.

**Logging Equipment**

Off-highway, heavy mechanical equipment used in the harvesting or processing of raw timber products in the field by loggers is exempt from the sales tax.

**Equipment Used in the Production of Maple Syrup**

The sales and use of equipment used in the production of maple syrup are exempt from sales tax.

**Wood Residue Used as Fuel in a Business Activity**

The sale of residue from the harvesting of timber for use as a fuel in a business activity is exempt from sales tax.

**Building Materials, Equipment and Supplies Used in the Construction of Professional Sports Stadiums**

Sales of building materials, equipment and supplies used solely in the construction of a sports stadium built or used by a professional sports team are exempt from the sales tax. This exemption applies to the Miller Park constructed by the Southeast Wisconsin Professional Baseball Park District and to Lambeau Field constructed by the Green Bay-Brown County Professional Football Stadium District.

**Game Birds and Clay Pigeons**

Sales of live game birds and clay pigeons to licensed bird hunting preserves.

**Trucks, Tractors, Buses and Other Vehicles Sold to Common or Contract Carriers**

Sales of trucks, truck tractors, buses, trailers and semi-trailers and accessories, parts and supplies sold to common or contract carriers are exempt from the sales tax. This exemption applies to urban mass transportation, bus and trucking companies, and other contract carriers.

**Rolling Stock Used in Railroad Operations**

Sales of locomotives, freight cars, and other rolling stock as well as accessories, attachments and fuel and lubricants used in railroad operations are exempt from the sales tax.

**Commercial Vessels and Barges**

Sales, storage, use or other consumption of commercial vessels and barges in excess of 50 tons and primarily engaged in interstate or foreign commerce or commercial fishing are exempt from the sales tax. Accessories, parts and fuel for these vessels are also exempt from the tax.

**Containers, Labels, Sacks, Cans, Boxes and Other Packaging and Shipping Materials**

Sales of containers, labels, sacks, cans, boxes and other packing, packaging and shipping materials, if such materials are used to transfer merchandise to customers, are exempt from sales tax. Packing, packaging and shipping materials, including meat casings, for use in meat packing, packaging or shipping meat are exempt from sales tax regardless of whether such materials are used to transfer merchandise to customers.

**Motion Picture and TV Film and Advertising Materials**

The sale, lease or rental, or storage, use or other consumption of motion picture films and of advertising material sold, leased or rented to movie theaters or radio or television stations is exempt from the sales tax.

**Restaurant Employee Meals**

Meals that are provided by a restaurant to the restaurant's employee during the employee's work hours are exempt from the sales tax.

**Tangible Personal Property Purchased for Resale but Donated to a Nonprofit Organization**

Property purchased tax-free for resale or under a valid exemption certificate and later donated to a nonprofit organization is exempt from the use tax.

**Prepaid Telephone Cards and Authorization Numbers**

Services obtained by the use of a prepaid telephone card or authorization number are exempt from sales tax if sales tax was paid on the card or authorization number at the time it was purchased.

**EXEMPTIONS FOR GOVERNMENT AGENCIES AND NONPROFIT ORGANIZATIONS****Sales to the Federal Government and Its Agencies**

Sales of goods and services to the federal government or to any of its incorporated or unincorporated agencies or instrumentalities are exempt from sales tax. Since taxing purchases by the federal government would violate the U.S. Constitution, the fiscal effect of this exemption has not been estimated.

**Sales to State and Local Governments and Schools**

The gross receipts from sales to, and the storage, use or other consumption of tangible personal property and taxable services by state, county, city, village and town governments, school districts, local exposition districts, local cultural arts district, local water authority and metropolitan sewerage districts are exempt from sales tax.

**Sales to Religious, Charitable, Scientific and Educational Organizations**

The gross receipts from sales to, and the storage, use or other consumption of tangible personal property and taxable services by any corporation, community chest, foundation or association organized and operated exclusively for religious, charitable, scientific or educational purposes are exempt from sales tax.

**Lunches and Other Tangible Personal Property Sold by Elementary and Secondary Schools**

Sales of tangible personal property by public or private elementary and secondary schools are exempt from sales tax. School lunches account for over 90% of these sales.

**Admissions to Elementary and Secondary School Activities**

Sales of tickets or admissions to public and private elementary and secondary school activities are exempt from the sales tax, if the net proceeds are used for educational, religious or charitable purposes. For example, revenue from admission fees to high school sporting events, school plays and other school activities are exempt from sales tax.

**Admissions to State Parks and Camping Fees**

Admission fees and camping fees at state park and state forest recreational areas are exempt from sales tax.

**Admissions to Certain Historical Museums**

Admissions to a museum operated by a nonprofit corporation under a lease agreement with the State Historical Society are exempt from sales tax. This exemption applies only to the Circus World Museum in Baraboo.

**Admissions to County Fairs**

Admissions to county fairs are exempt from sales tax.

**Volunteer Fire Department Equipment**

Sales of fire trucks and other fire-fighting equipment to volunteer fire departments are exempt from sales tax. This exemption applies to hoses, exhaust fans, generators, ladders and other firefighting equipment.

**Copies of Public Records**

Copies of public records, including fees for searches, are exempt from sales tax.

**Sales by American Legion Baseball Teams**

Sales of tangible personal property, tickets and admissions by American Legion baseball teams are exempt from sales tax.

**Snowmobile Trail Grooming Equipment**

Snowmobile trail groomers and attachments are exempt from sales tax when purchased by snowmobile clubs for use in maintaining the state system of snowmobile trails. To qualify for the exemption, an organization must meet at least three times a year and have at least 20 members.

**Charges for Emergency Telephone Systems**

Charges levied by a county or group of counties to finance an emergency (911) telephone system are exempt from the sales tax. Charges imposed by the Public Service Commission of Wisconsin (PSC) to fund implementation of enhanced (E911) emergency services are exempt. The PSC is expected to promulgate administrative rules setting E911 charges in 2005.

**Sales of Animal Identification Tags and Samples by the Department of Agriculture, Trade and Consumer Protection**

Sales by the Wisconsin Department of Agriculture, Trade and Consumer Protection of animal identification tags to persons who are required or authorized to use those identification tags, and sales of standard samples representing product or commodity grades are exempt from the sales tax.

**Public Benefits Fees**

Public benefits fees, surcharges on residential and commercial electric bills used to fund low-income energy assistance and energy conservation and efficiency programs, are exempt from sales tax.

**One-Time License or Right to Purchase Admissions to Professional Football Games**

The sale by a municipality, a local professional football stadium district or a professional football team of a one-time license or similar right to purchase admission to at least three games at a football stadium in a season is exempt from the sales tax. The exemption applies to the sale of admission rights whose proceeds will be used to help finance the renovation of Lambeau Field in Green Bay.

**Motor Vehicles Loaned to Driver Education Programs**

The loan by an automobile dealer of a motor vehicle for a driver education program conducted by a school or school district is exempt from use tax.

**EXEMPTIONS FOR NONRESIDENTS AND FOR USE IN OTHER STATES****Interstate Commerce**

Tangible personal property shipped in interstate commerce is not subject to sales tax. The fiscal effect of this exemption has not been estimated because taxing such property is prohibited by the U.S. Constitution.

**Property Used in the State by Nonresidents**

Tangible personal property brought into the state by nonresidents of Wisconsin for their own use, storage, or other consumption while temporarily in Wisconsin is exempt from use tax. However, if the property is used to conduct a trade, business or profession, or used in the performance of personal services for wages or fees, the value of the property is subject to the tax.

**Nonresidents' Boats Berthed in Boundary Waters**

Generally, a boat that is owned by a resident of another state and berthed in Wisconsin is subject to use tax, if the owner did not pay sales tax when purchasing the boat. However, the boat is exempt from use tax if: (1) the boat owner is a resident of a state contiguous to Wisconsin, (2) the boat is berthed in boundary waters adjacent to the owner's state of residence, and (3) the purchase of the boat was an exempt occasional sale.

**Nonresidents' Aircraft Hangared in Wisconsin**

Aircraft purchased in another state by a nonresident individual or business and kept in a hangar in Wisconsin is exempt from use tax.

**Goods Brought into the State by New Residents**

Household goods purchased outside of Wisconsin but brought into the state by new residents are exempt from use tax if the goods are purchased 90 or more days prior to the date the person moves to Wisconsin. This exemption applies to all household goods, including automobiles and other registered vehicles, purchased for personal use.

**Property Purchased for Use Outside the State**

Sales of tangible personal property purchased for use outside the state and sales of property delivered and prepared for export are exempt from sales tax. For example, items such as office supplies and paper products sold to persons outside the state are exempt from the sales tax.

**Aircraft, Motor Vehicles and Truck Bodies Sold for Use Outside the State**

Sales of aircraft, motor vehicles and truck bodies to nonresidents who will not use such units in Wisconsin are exempt from the sales tax. This exemption also applies to aircraft, motor vehicles and truck bodies sold to foreign governments and to certified carriers of people or property in interstate or foreign commerce.

**Property Sold to Out-of-State Common or Contract Carriers**

Sales of tangible personal property to common or contract carriers engaged primarily in trucking and sales to railroad companies are exempt from the sales tax, if the property is shipped to a destination outside this state. Wisconsin, for example, is a major producer of railroad ties, and all shipments of railroad ties out of state are exempt from sales tax.

**Printed Advertising Material Used Outside the State**

Sales of printed advertising materials produced in Wisconsin and sold to purchasers for use only outside the state are exempt from the sales tax. For example, advertising leaflets, which are printed and purchased in the state but distributed only in a neighboring state, are not be subject to sales tax.

**Temporary Storage of Printed Materials**

The temporary storage of raw materials that are incorporated into printed materials to be transported outside Wisconsin, and thereafter used solely outside Wisconsin, are exempt from sales and use tax. An example of printed materials qualifying for the exemption would be paper purchased by a company from an out-of-state vendor and delivered to a Wisconsin printer that prints catalogs for the purchaser, if the catalogs are distributed only outside Wisconsin.

**DEFINITIONAL AND MISCELLANEOUS EXEMPTIONS****Exemptions That Further Define Retail Sales**

The purpose of this exemption report is to estimate the cost to the state of providing specific exemptions to the sales tax for items that would otherwise be taxable. A retail sale is defined as one where the buyer makes a purchase with no intention of resale. By law, retail sales are subject to the sales tax, unless otherwise stated. However, some sections of the statutes clarify the definition of a retail sale to exclude certain transactions from tax. For these sections no fiscal estimates have been made because sales of these items are not retail sales.

The following transactions fall into this category:

- Charges for interest, financing or insurance when such charges are stated separately. [s. 77.54 (8)].
- Transfer of property to a corporation upon its organization solely in consideration for the issuance of its stock. [s. 77.51 (14g)(a)].
- Contributions of property to a newly-formed partnership solely in consideration for a partnership interest. [s. 77.51 (14g)(b)].
- Contributions of property to a limited liability company upon its organization solely in consideration for a membership interest. [s. 77.51 (14g)(bm)].
- Transfer of property to a corporation for the issuance of its stock pursuant to a merger or consolidation. [s. 77.51 (14g)(c)].

- Transfer of property to a limited liability company for a membership interest pursuant to a merger. [s. 77.51 (14g)(cm)].
- Distribution of property by a corporation to its stockholders as a dividend or in liquidation. [s. 77.51 (14g)(d)].
- Distribution of property by a partnership to its partners in liquidation. [s. 77.51 (14g)(e)].
- Distribution of property by a limited liability company to its members in liquidation. [s. 77.51 (14g)(em)].
- Repossession of property when the only consideration is cancellation of the purchaser's obligation to pay the balance of the purchase price. [s. 77.51 (14g)(f)].
- Transfers of property in a reorganization in which no gain or loss is recognized for Wisconsin franchise or income tax purposes under ss. 71.301 to 71.368. [s. 77.51 (14g)(g)].
- Accounts that are found to be worthless, uncollectible and charged off for income tax purposes. [ss 77.51 (4)(b)4 and 77.52 (6)].
- The portion of a sales price that is either refunded in cash or credit as a result of property returned. [s. 77.51 (4)(b)2].
- The transfer of electric transmission facilities to a transmission company. [s. 77.51 (14g)(fm)].

### **Labor Input into Construction**

Materials used in construction are subject to sales tax; however, the value added by construction contractors is not taxed. Construction is a volatile sector of the economy and, as a result, the cost of this exemption fluctuates from year to year.

### **Trade-Ins and Lemon Law Refunds**

In transactions in which a product is traded in on the purchase of a product of greater value, sales tax is applied only to the difference between the values of the two products. The estimate applies only to trade-ins of automobiles and trucks; it does not include trade-ins of boats, mobile homes, household appliances or other items. Also, a customer applying a lemon law refund may apply the value of the original trade-in to the replacement vehicle.

### **Transportation Charges**

Transportation charges are exempt from sales tax if the charges are stated separately, and if the transportation occurs after the purchaser takes possession of the property.

### **Occasional Sales**

Occasional sales are sales by persons other than those offering goods for sale in the ordinary course of business. Taxable occasional sales include sales of automobiles, aircraft, trailers, semi-trailers, snowmobiles, all-terrain vehicles, and mobile homes not exceeding 45 feet in length, registered in the state, and boats registered in the state or in the U.S. However, these occasional sales are exempt only if the transfer is to a spouse, parent or child, or the spouse of a parent or child, and if the item had previously been registered in Wisconsin, or in the case of boats, registered in the state or in the U.S. Also, the transfer of a motor vehicle from an individual to a corporation solely owned by that individual is exempt. All other occasional sales are exempt from sales tax.

### **Auction Sales**

Gross receipts from auctions of farm personal property or household goods that are not held at regular intervals are exempt from sales tax.

### Retailer's Discount

Retailers may retain 0.5% of their tax liability or a minimum of \$10 per filing period as compensation for the costs of collecting and remitting sales taxes.

### SERVICES NOT SUBJECT TO TAX

Services are exempt from sales tax unless the statutes specifically impose the tax. Data are not available to estimate the total cost of not taxing services. However, the following table shows major services that are not subject to sales tax and provides an estimate of the potential fiscal effect. The table does not include services that are specifically exempted from tax by the statutes and discussed in previous sections, such as coin-operated laundry services, diaper services, veterinary services for farm animals and labor services in construction.

**TABLE 4**  
**SALES AND USE TAX EXEMPTIONS-SERVICES**

Exemption	FY04 Fiscal Effect
<b>Personal and Recreational Services</b>	
Beauty, Barber, Nail and Other Personal Care Services	\$29,200,000
Funeral Services, excluding Caskets and Vaults	7,000,000
Bank Account Service Charges	20,200,000
Dues and Fees Paid to Business Associations and Fraternal Organizations	12,800,000
Health Clubs	3,300,000
Admissions to Educational Events and Places	4,900,000
Veterinary Services for Pets	13,300,000
Dance Studios	1,400,000
Auto and Travel Clubs	2,300,000
<b>Professional Services</b>	
Services of Physicians, Dentists and Other Health Professionals	384,000,000
Legal Services	113,000,000
Architectural, Engineering and Surveying Services	75,000,000
Accounting Services	56,000,000
Tax Preparation Services	3,800,000
<b>Business Services</b>	
Advertising	103,000,000
Computer Services (including data processing and custom programming)	136,000,000
Management Consulting and Public Relations	56,000,000
Employment Placement Services	10,500,000
Addressing and Mailing	10,000,000
Credit Rating and Collection Services	10,500,000
Investigation and Security Services	17,100,000
Scientific Research and Development Services	65,000,000
<b>Services Related to Real Property</b>	
Commissions to Real Estate Brokers	35,100,000
Repair of Real Property	31,000,000
Interior Design	4,300,000
Janitorial Services	34,100,000
Disinfecting and Exterminating	2,800,000
Sewerage Services	24,600,000
Carpet and Upholstery Cleaning Services	3,600,000

## INSURANCE PREMIUM TAXES

### Introduction

Chapter 76 of the Wisconsin Statutes provides for the taxation of certain insurance companies by the Commissioner of Insurance on the basis of premiums or net investment income. Insurance business subject to taxation under Chapter 76, Wis. Stats., is not subject to the corporate income and franchise tax under Chapter 71, Wis. Stats., and vice versa. Some types of insurance companies are not subject to taxation under either chapter.

The tax imposed by Chapter 76, Wis. Stats., may apply to all insurance companies, foreign (companies organized outside Wisconsin) as well as domestic (organized in Wisconsin). The corporate franchise tax applies to domestic fire and casualty insurers and the nonlife business of domestic life insurers.

Insurers exempt from taxation under both Chapters 71 and 76, Wis. Stats., include: fraternal or mutual benefit societies; town mutual insurance companies (except that fire dues are payable equal to 2% of the fire premiums); voluntary benefit plans for injury or death of students; self-insurers (except that fire dues are payable equal to 2% of the premiums that would have been charged by authorized insurers); the State Property Insurance Fund (except for fire dues on nonstate-owned property); and the Wisconsin Health Care Liability Plan and Patients Compensation Fund.

Insurance companies subject to the corporate income and franchise tax are subject to the same tax rate as that imposed on all other corporations subject to the tax, except that the tax is limited to 2% of premiums. The tax rates for insurance companies subject to taxation under Chapter 76, Wis. Stats., vary depending on the type of insurance business. In addition, because of "reciprocal and retaliatory" statutes, Wisconsin taxation of foreign insurance companies (companies organized outside the state) is dependent on the taxation of Wisconsin-organized insurance companies in the domicile of such foreign companies. For example, the Wisconsin taxation of a New York company doing business in Wisconsin is dependent on the New York taxation of a Wisconsin company doing business in New York.

The Wisconsin "retaliatory" statute provides, in essence, that when the taxes/fees imposed by another state or country on insurers organized under Wisconsin laws doing business in that state or country are greater than the taxes or fees imposed by Wisconsin on those foreign insurers doing business in Wisconsin, then Wisconsin will tax insurers organized under the laws of the other state or country at the same higher rate.

The Wisconsin "reciprocal" statute provides that insurers organized under the laws of other states, territories or districts of the United States (but not other countries) shall not pay taxes, fees or licenses to Wisconsin greater than the taxes, fees or licenses imposed by the other state, territory or district on similar Wisconsin insurers doing business there. The reciprocal statute does not result in pure reciprocity because it does not apply to insurance companies organized in other countries, and it does not permit payment of less than the Wisconsin statutory tax on life insurance, fire dues (2% fire department dues) and certain fees. In addition, it requires a minimum tax of 0.375% on fire and ocean marine premiums.

Because some Wisconsin companies do insurance business in all other states, territories or districts of the United States, the effect of the reciprocity and retaliation statutes is that few U.S. fire or casualty insurers are taxed at the rates provided in the Wisconsin Statutes (except the 0.375% minimum tax on fire and ocean marine premiums). In general, the "retaliatory" statutes applicable to insurers organized in other countries cannot be applied because of limitations imposed by international treaties between the United States and the insurer's domiciliary country, or because of practical problems of application or computation. Thus, non-U.S. insurers are taxed at the Wisconsin statutory rate. The statutory rates are as follows: fire, 2.375%; ocean marine, 0.5%; casualty, 2%; domestic life (over \$750 million in force), 2%; domestic life (\$750 million or less in force), 3.5% of gross income (this tax plus a valuation fee is subject to a maximum of 2% of net taxable premiums); nondomestic life, 2%; and nondomestic accident and health, 2%.

For the premium tax, the base is gross premiums received for direct insurance less return premiums and cancellations and policyholder dividends from savings and gains on direct insurance in Wisconsin. Direct insurance includes all insurance other than reinsurance. Under reinsurance, an insurer shares the risk and premiums with other insurers.

General purpose revenue tax collections from the insurance premiums taxes in FY04 were \$108.9 million. This excludes \$14.7 million of fire department dues, which is program revenue. Fire department dues are distributed to local units of government.

**TABLE 1**  
**INSURANCE PREMIUM TAX EXEMPTION DEVICES SUMMARY**

Exemption Device	Statutory Reference*	FY04 Fiscal Effect
<b>Exemptions from Taxation</b>		
Town Mutual Insurance Companies	s. 76.61	\$1,288,000
Domestic Fire, Marine and Casualty Companies	ss. 76.60 and 76.63 (1)	198,090,000
Fraternal Life Insurance Companies	s. 76.65	4,577,000
<b>Exemptions From Base</b>		
Return Premiums and Cancellations on Direct Insurance	ss. 76.60, 76.62 and 76.63 (1)	**
Exemptions from the Domestic Life Insurance Company Gross Income Tax Base	s. 76.65 (1)	None
Exemptions from the Foreign and Domestic Life Insurance Company Gross Premium Tax Base	s. 76.65 (2)	1,091,000***
<b>Special Treatment</b>		
Limit on Gross Income Tax of Domestic Life Insurance Companies with \$750 Million or Less of Insurance in Force	s. 76.65 (1)	None
"Retaliatory" Statute	s. 76.66	Not Available
"Reciprocity" Statute	s. 76.67	31,689,000
<b>Credits</b>		
Credit to Domestic Life Insurers for Personal Property Taxes	s. 76.69	570,000
Credit to Insurers to Recoup Security Fund Assessments	s. 646.51 (7)	**
Credit to Insurers for Certified Capital Investment	s. 76.635 (2)	4,790,000

\*References to sections of the 2003 Wisconsin Statutes.

\*\*Included in estimates for exemption for domestic, fire, marine and casualty companies and for "reciprocity" statute.

\*\*\*Fiscal effect for domestic insurers only. Fiscal effect for foreign corporations included in the estimate for "reciprocity" statute.

## EXEMPTIONS FROM TAXATION

### Town Mutual Insurance Companies

Town mutual insurance companies organized under or subject to Chapter 612 of the Wisconsin Statutes are not subject to taxation or license fees under Chapter 76, Wis. Stats. They are subject, however, to fire dues of 2% of direct fire premiums. A town mutual insurance corporation may be organized by at least 100 adults, each of whom has a separate insurable risk within a prescribed territory. The territory may not exceed eight contiguous counties; however, the Commissioner of Insurance may allow a broader territory not larger than 16 contiguous counties. A town mutual may insure members against loss or damage from any cause to any property in which a member has an interest, including insurance against loss of use or loss of income from property. The insurance of crops and other property against loss due to windstorm or hail are restricted and must be reinsured. Town mutual insurers may insure policy holders from liability, errors and omissions and medical payments and other supplemental coverage when reinsured.

### Domestic Fire, Marine and Casualty Companies

Wisconsin-organized insurance companies insuring fire, marine and casualty risks are not subject to Wisconsin premium taxation with the exception of mortgage guaranty insurers. Companies not subject to the premiums tax are subject to the corporation franchise tax. They are subject to fire dues of 2% of direct fire premiums written. Casualty risks also include all lines of accident and health insurance written by life companies, fraternal insurers, health maintenance organizations, limited service health organizations, and health medical dental indemnity insurers.

## **Fraternal Life Insurance Companies**

All corporations transacting life insurance business in Wisconsin are subject to taxation under Chapter 76, Wis. Stats., except fraternal insurers organized and operating under Chapter 614 of the Wisconsin Statutes. A fraternal insurer must have a lodge system and a representative form of government. It must exist solely for the benefit of its members and their beneficiaries and solely for any lawful social, intellectual, educational, charitable, benevolent, moral, fraternal, patriotic or religious purposes for the benefit of its members or the public, carried on through voluntary activity of its members in their local lodges or through institutional programs of the fraternal or its lodges. It may carry only life and accident and health lines of insurance.

## **EXEMPTIONS FROM BASE**

### **Return Premiums and Cancellations on Direct Insurance**

For the tax on fire, marine and casualty insurance premiums, the tax base is defined as gross premiums as calculated under sec. 76.62, Wis. Stats. This section provides that all license fees and taxes levied under any provision of law upon gross premiums other than life insurance premiums shall be based on gross premiums received for direct insurance, less return premiums and cancellations, and returns from savings and gains on all insurance, other than reinsurance by the insurer during the preceding year in this state.

Reinsurance, whereby one insurer shares a portion of the premium in return for a sharing of a portion of the risk with another insurer, is not subject to taxation unless the original insurer fails to pay the premiums tax. The fiscal effect of this exemption for domestic companies is included in the exemption from taxation for domestic fire, marine and casualty companies; for foreign companies, it is included in the estimate for the "reciprocity" statute.

### **Exemptions from the Domestic Life Insurance Company Gross Income Tax Base**

The tax base for domestic (Wisconsin organized) life insurance companies (which may affect only those companies with \$750 million or less of insurance in force) is gross income from all sources, except:

1. interest required to provide and maintain reserves according to the laws of Wisconsin, and
2. premiums collected on policies of insurance and contracts for annuities.

The gross income, net of the above deductions, is subject to a factor with the numerator being net investment income applicable to life insurance and annuities and the denominator being total net investment income.

### **Exemptions from the Foreign and Domestic Life Insurance Company Gross Premium Tax Base**

The tax base for foreign life insurance companies, which is also applicable to domestic life insurance companies having more than \$750 million of insurance in force and may affect those with \$750 million or less of insurance in force, is gross premiums on all policies or contracts of insurance on the lives of residents of Wisconsin less all sums apportioned to premium-paying policies on the lives of residents of Wisconsin from annual distributions of profits, savings, earnings or surplus that have been either paid in cash or applied in partial payment of premiums. Because of long-standing administrative construction, considerations received for annuity contracts are not considered premiums on policies or contracts of insurance and, thus, are not taxable under sec. 76.65 (2), Wis. Stats. The fiscal effect shown is that for domestic insurers; the fiscal effect for foreign companies is included in the estimate for the "reciprocity" statute.

## **SPECIAL TREATMENT**

### **Limit on Gross Income Tax of Domestic Life Insurance Companies with \$750 Million or Less of Insurance in Force**

For domestic life insurance companies with \$750 million or less of insurance in force, the tax based on 3.5% of gross income (less deductions) cannot exceed the annual license fee that would have been payable had it been operating as a foreign company (in which case the tax would be 2% of gross premiums, after deducting considerations received for annuity contracts). This limit had no fiscal effect in FY04.

### **"Retaliatory" Statute**

The Wisconsin "retaliatory" statute may result in an increase in Wisconsin fees, thus it might not be considered a tax exemption device. However, to the extent that the statutes of other states provide tax exemption devices for insurance companies organized in Wisconsin doing business in such states, the Wisconsin "retaliatory" statute could also allow such tax exemption devices to insurance companies doing business in Wisconsin. The fiscal effect of these other states' statutes are included in the estimate for the "reciprocity" statute.

### **"Reciprocity" Statute**

To the extent that insurance companies organized in Wisconsin operating in the United States outside Wisconsin are subject to taxation to a lesser extent than otherwise provided by Wisconsin law, the Wisconsin "reciprocity" statute may provide reduced taxation for non-Wisconsin companies organized in the United States for business transacted in Wisconsin. The limitations of the "reciprocity" statute are described in the introduction.

## **CREDITS**

### **Credit to Domestic Life Insurers for Personal Property Taxes**

Domestic life insurance companies are allowed a premiums tax credit of 50% of general property taxes paid on personal property in Wisconsin used in the operation of business and not held primarily for investment purposes. The credit is limited to 25% of the license fee for domestic life insurers.

### **Credit to Insurers to Recoup Security Fund Assessments**

The Insurance Security Fund Board administers the security fund established by Chapter 646, Wis. Stats., to provide a mechanism for protecting insureds in the event of liquidation of insurers and to assess the costs of such protection among insurers. Sec. 646.51 (7), Wis. Stats., provides for tax credits of 20% of security fund assessments in each of the five calendar years following the year the assessment was paid when premium rates are fixed so that it is not possible for the insurer to increase its premium rates to recoup the assessment. Domestic insurers may take tax credits only for the proportion of their business assessed which is fixed, such that it is impossible to raise premiums. Such policies are referred to as "noncancellable" in the insurance business and represent a small portion of the total insurance written. Nondomestic insurers may take tax credits subject to the provision of the retaliatory and reciprocal statutes (secs. 76.66 and 76.67, Wis. Stats.)

### **Credit to Insurers for Certified Capital Investment**

Certain insurers operating in Wisconsin are allowed to take a premium tax credit for investment in certified capital companies as defined in sec. 560.30, Wis. Stats. The purpose of the credit is to encourage insurers to provide venture capital for companies operating in Wisconsin. The tax credit equals up to 10% of the amount of the certified investment each year, until the entire available credit is used.

## PROPERTY TAX

Local governments, including municipalities, counties, school districts, vocational technical college districts and special districts, levy a tax on most real property (land and improvements) and selected types of personal property in the state. Property tax rates are commonly expressed in terms of dollars per \$1,000 in property value, which is referred to as the mill rate. In addition, the state levies a forestry tax equal to two-tenths of one mill (0.02%), the proceeds of which are deposited in the state conservation fund.

The property tax is the largest source of state and local tax revenues in Wisconsin. Net taxes levied in 2003 and collected in 2004, after reduction for the school levies credit paid by the state to municipalities, were \$7.2 billion. The total taxable value of property was \$360.7 billion, and the statewide average net tax rate was 20.01 mills (2.001%).

Owners of several kinds of exempt real property are required to report to the municipality in which the property is located an estimated fair market value of the exempt property as of January 1 of each even-numbered year. Municipalities submit these reports to the Department of Revenue, which tabulates the data from them and estimates the total value of tax exempt real property by category of owner.

Owners of pollution treatment and abatement plant and equipment, manufacturing machinery and equipment, crops, manure storage facilities, secondary containment structures, certain housing authority property, cemeteries, and archaeological sites are not required to file reports. In addition, legislation enacted in 1996 repealed the reporting requirement for the state, municipalities, school districts, and certain special purpose districts. Also, the value of federal property is not reported. Thus, the report focuses on exempt private real property.

### Real Property Tax Exemption Value Data

The "Taxation District Exemption Summary Report" on page 72 summarizes data for the municipalities that filed Taxation District Exemption Summary Reports with DOR by September 9, 2004. Of the total of 1,907 taxation districts, 751 had not filed as of that date.

To estimate total values for each category of property, the number of parcels in each value cell for a category is multiplied by the midpoint of the range of values for that cell, and the results summed. Thus, for the "place of worship" classification, the 164 parcels in the \$1 to \$10,000 range multiplied by \$5,000 is added to the 819 parcels in the \$10,001 to \$100,000 range multiplied by \$55,000, and so on for each value category and each category. Based on this aggregation, the value of the 16,524 exempt parcels in the summary report is \$17.2 million.

An adjustment was made for the 751 municipalities that had not filed. First, the total taxable value of the towns among the 751 non-filers was determined. This value was multiplied by 2.2%, which is the percent of total taxable property reported by the filing towns to be exempt. Similar computations were made for the villages and cities among the 751 non-filers. The average exemption rate for villages was 4.8%; for cities it was 8.9%. Based on this approach, the value of exempt real property in the 751 non-filing municipalities was estimated to be \$4.5 billion which, when added to the \$17.2 billion for the municipalities that filed, produced a total of \$21.7 billion.

The cost of the exemptions increases as property values increase and as the number of exemptions increases. The \$21.7 billion estimate represents a 17% increase from our estimate two years ago of \$18.6 billion.

Table 1 shows the percentage of total exempt property by purpose for 2004, and the estimated value of that property. The percentages, which are based on the reports filed by taxation districts, are used to allocate the estimated \$21.7 billion in exempt property by purpose.

The table shows that, of the estimated \$21.7 billion of exempt private property, "place of worship" is the largest category with about 33.4% of the total, or \$7.3 billion. "Non-profit hospitals" is the second largest category with 12.0% or about \$2.6 billion. "Public benefit" is the third largest category with 9.7% or \$2.1 billion in exempt property. This category includes the properties owned by YMCAs, YWCAs, Scouts, Boys' Clubs, and similar organizations. "Grades K-12" and "Private Colleges" comprise 8.5% and 6.6% respectively of exempt property, equal to a combined \$3.3 billion.

**TABLE 1**  
**ESTIMATED VALUE OF EXEMPT PRIVATE REAL PROPERTY, 2004**

Purpose of Property	Percent of Total		Exempt Value (\$ Million)	
<b>RELIGIOUS:</b>				
Place of worship	33.4%		\$7,268	
Church – Other	4.0%		872	
<b>SUBTOTAL</b>		37.4%		\$8,140
<b>EDUCATIONAL:</b>				
Grades K-12	8.5%		1,842	
Private College	6.6%		1,428	
Educational – Other	3.6%		774	
<b>SUBTOTAL</b>		18.6%		4,044
<b>MEDICAL FACILITY:</b>				
Non-profit Hospital, incl. religious	12.0%		2,617	
Medical Research Foundation	0.7%		155	
Medical – Other	1.3%		274	
<b>SUBTOTAL</b>		14.0%		3,046
<b>HOUSING:</b>				
Nursing Home, incl. religious	4.4%		965	
Retirement Home, incl. religious	4.5%		979	
Housing – Other	6.0%		1,296	
<b>SUBTOTAL</b>		14.9%		3,240
<b>PUBLIC BENEFIT</b>		9.7%		2,103
<b>OTHER</b>		5.4%		1,165
<b>TOTAL</b>		100.0%		\$21,738

### Personal Property

Most personal property, such as household furniture and furnishings, machinery and equipment used in manufacturing, computer equipment, pollution abatement equipment and inventories are exempt from the property tax. This section estimates the value of selected categories of personal property owned by businesses.

*Machinery and equipment used in manufacturing.* The exemption of machinery and equipment used in manufacturing greatly reduces the property tax burden on manufacturers. There are approximately 10,600 manufacturers in the state. It is estimated that 10% of all manufacturing machinery and equipment is taxable. In 2004, \$1.32 billion of machinery and equipment was taxable. Thus, approximately \$11.9 billion of machinery and equipment used by manufacturers is currently exempt from tax.

*Treatment plant and pollution abatement equipment.* Waste treatment facilities that remove, alter or store waste materials are exempt from general property taxation. No estimate of the value of property not subject to tax because of this exemption is available because owners of the property are not required to submit such information to the Department of Revenue.

*Computers.* Wisconsin exempts personal computers, monitors, software, and operational systems from the property tax, and provides aids to local governments to compensate them for the lost tax base. In FY04, nearly \$3.1 billion in computer equipment was exempt, and the computer aid payment was \$73.5 million.

For these personal property exemptions for which we have the information necessary to make an estimate the total exempt value totals \$15.1 billion.

### Effect of Exempt Property on Tax Rates

Table 2 examines the extent to which property tax rates could be reduced if the exempt property whose value is estimated in this report were subject to tax. The table shows the estimated 2004 average net property tax

rates for towns, villages, cities, and statewide, as well as tax rates calculated under the assumption that the estimated \$21.7 billion of exempt private real property and \$15.1 billion of exempt personal property are added to the tax rolls. The analysis assumes that there would be no change in the overall level of state and federal aids and no change in total property tax levies.

Table 2 indicates that, if the reported exempt private real and personal property had been placed on the tax roll in 2003/04, the statewide average net property tax rate would have declined by 10.9% from \$19.91 to \$17.74 per \$1,000 of value. Under this scenario, total net tax rates in cities, villages, and towns would have been lower by 15.7%, 12.9%, and 3.4%, respectively. The larger impact in cities and villages reflects the fact that exempt property – schools, hospitals, public housing – is more likely to be located in urban than in rural areas.

**TABLE 2**  
**AVERAGE NET TAX RATES FOR 2003, COLLECTED IN 2004 (PER \$1,000 VALUE)**

For Property In	Actual Rate (\$)	Rate if Exempt Private Real and Personal Property Were Taxable	Percentage Change
Cities	\$22.75	\$19.18	-15.7%
Villages	19.72	17.17	-12.9
Towns	16.60	16.03	-3.4
Statewide Average	19.91	17.74	-10.9

### Evaluation

There are several limitations to the estimates provided in this chapter. First, the reported data are incomplete because reports from 751 taxation districts had not been received by the time the report was prepared, and the value of exempt property in these districts had to be estimated.<sup>1</sup> In addition, because the value is reported in ranges, our use of a midpoint could be over or underestimating the true average value of the exempt properties even for those who did report. Also, the value of exempt machinery and equipment, inventories and computers had to be estimated. In addition, the value of exempt federal, state, and local government property is not included in this report.

Second, there may be systematic underestimation of exempt property values reported for at least two reasons: (1) a lack of knowledge of the value of often highly-specialized property, which has not been on the market in many years and which is not likely to be offered for sale in the foreseeable future, and (2) a desire to minimize the perceived benefit of the tax exemption for political reasons. However, the data were not audited and, therefore, underestimation cannot be confirmed.

Due to the limitations of these data, care should be taken in using them to represent exempt property values. Care should also be taken in comparing these data to prior years' reports due to the changes in 1996 in reporting requirements and reporting forms.

<sup>1</sup> The 751 municipalities were comprised of 583 towns, 119 villages and 49 cities.

# TAXATION DISTRICT EXEMPTION SUMMARY REPORT FOR 2004 (S. 70.337(2), Wis. Stats.)

See instructions on bottom of form.

CO \_\_\_\_\_ MUN \_\_\_\_\_ FOR \_\_\_\_\_ T-V-C \_\_\_\_\_ OF \_\_\_\_\_ NAME OF TAXATION DISTRICT \_\_\_\_\_, \_\_\_\_\_ NAME OF COUNTY \_\_\_\_\_

INDICATE NUMBER OF PROPERTIES BY PURPOSE OF PROPERTY WITHIN EACH VALUE CATEGORY											
	1	2	3	4	5	6	7	8	9	10	
PURPOSE OF PROPERTY	\$1- \$10,000	\$10,001- \$100,000	\$100,001- \$200,000	\$200,001- \$500,000	\$500,001- \$1,000,000	\$1,000,001- \$3,000,000	\$3,000,001- \$6,000,000	\$6,000,001- \$12,000,000	\$12,000,001- \$25,000,000	Over \$25,000,000	Total No. of Properties
WORSHIP	164	819	779	1,032	820	972	231	46	10	26	4,899
CHURCH-OTH	476	1,034	446	172	96	70	25	5	3	2	2,329
EDU, K-12	44	98	49	100	02	150	58	31	16	5	653
COLLEGE	21	95	66	4	18	29	29	24	9	13	338
EDU-OTH	89	158	72	93	61	50	19	11	6	3	562
HOSPITAL	18	142	27	14	17	28	13	15	30	31	335
MED RSCH	0	2	2	4	2	6	2	0	1	2	21
MED-OTH	40	86	22	14	25	20	10	5	3	0	225
NURSING	9	10	7	3	10	26	23	20	14	4	126
RETIRE	13	32	15	52	21	49	43	13	7	5	250
HOUSE-OTH	49	720	758	263	100	91	33	10	9	3	2,036
BENEFIT	512	907	327	317	129	148	46	19	11	12	2,428
OTHER	777	884	261	186	96	78	19	9	5	7	2,322
TOTAL NO. OF PROPERTIES	2,212	4,987	2,831	2,284	1,497	1,717	551	208	124	113	16,524

NAME OF CLERK (please print)	TELEPHONE NUMBER (     )
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## INSTRUCTIONS

Enter the number of exempt properties in your municipality in each value range by purpose or use of property. You can gather this information from the PC-220 forms which are filed by the property owner. A parcel with more than 1 building and more than 1 use should be recorded for each use. Example: For a parcel with a church valued at \$500,000 and a parsonage valued at \$150,000 enter 1 property in the 1<sup>st</sup> value category under WORSHIP and enter 1 property in the 11<sup>th</sup> value category under HOUSE-OTH.

Enter the total number of properties by organization category in the right hand column.

Enter the total number of properties within each value range in the total line at the bottom.

Enter the name and telephone number of the person completing this form.

P-C 226 (R. 7-01)

Note: You should send form PC-227 to organizations reporting to be subject to taxation under sections 511 to 515 of the IRC (see s. 70.339, Wis. Stats.).

Complete and mail this form by July 1 to:

Wisconsin Department of Revenue  
Bureau of Local Financial Assistance  
P. O. Box 8933  
Madison, WI 53708-8933

## FOREST CROP AND MANAGED FOREST LAWS

The Forest Crop and Managed Forest Laws extend special property tax treatment to owners of qualifying forest land. The Forest Crop Law was enacted in 1927 as a means of promoting private forestry in the state. The law was closed to new entrants when the Managed Forest Law went into effect in 1986.

### Historical Background

In the early 1900s, Wisconsin was a major timber producer. By the 1920s, much of the state's forest land had been cut-over or damaged by fire. Many owners of cut-over or burned forest land hoped to sell their land for farming. However, the precipitous drop in farm commodity prices in the early 1920s caused a dramatic fall in farm income and farm land prices. Facing a poor land market, forest land owners grew unwilling or unable to pay their property taxes. Few buyers offered to redeem land at tax sales, obliging counties to assume ownership. Since county-owned land is tax exempt, as the amount of land in county ownership grew, property taxes on other land increased. The result was a fiscal crisis for local governments dependent on property taxes.

The economic problem for forest land owners was simple. While a farmer paid his taxes from the net proceeds of annual crops, a forest land owner paid his taxes on the value of his land and timber even if a harvest would not occur for many years. It was thought that easing the annual tax burden of forest land owners could prevent further land abandonment and even encourage reforestation. Local governments, however, were unwilling to forgo the taxes they were able to collect on forest land.

The Legislature found a compromise solution to the problem, but it required an amendment to the uniformity in taxation clause of the state constitution that created an exception for forest land. The amendment was approved by voters in 1927. Later that year, the Forest Crop Law (FCL) was enacted. Under the FCL, land is taxed at a constant annual rate while timber is taxed only when harvested. Land was enrolled under the FCL under 25- or 50-year contracts and required the owner to develop a merchantable timber crop. Owners also had to permit public access for hunting and some recreational purposes.

A program similar to the FCL for owners of small forest plots, the Woodland Tax Law (WTL), was enacted in 1954. WTL contracts were for 15 years. The last WTL contracts expired in 2000.

The Managed Forest Law (MFL) program was enacted in 1985 to replace the FCL and WTL. Part of the rationale behind the MFL was to encourage enrollment by non-industrial forest land owners. Experience under the FCL indicated that non-industrial land owners objected to the public access requirements. The MFL tried to ease these concerns by permitting owners to close some of their land to public access.

### Provisions of the Forest Crop Law (FCL)

Under the FCL, an owner of a complete quarter-quarter section (typically 40 acres) in a town or village could petition the Department of Natural Resources (DNR) to enroll that land in the program. If the DNR determined that forestry was the best use for the land and that a stand of merchantable timber would be produced within a reasonable period of time, the land was entered under the program. Enrollment contracts were for 25 or 50 years, at the landowner's option. The owner was required to practice forestry, to notify the DNR of timber harvests, to allow state appraisals of harvested products, and to permit public access for hunting and recreation. FCL land is exempt from property taxes. In lieu of taxes, owners must make an annual "acreage share" payment to the town or village. Owners are also required to pay a severance tax to the DNR equal to 10% of the value of any forest products that are harvested. Certain penalties can also be imposed if the owner fails to comply with the contract or if the owner withdraws the land from the program before expiration of the contract.

1. **Acreage Share.** This payment is made to the municipality where the land is located. The municipality retains 80% and remits 20% to the county. On land entered prior to 1972 the payment is \$0.10 per acre. On "special provision" land (entered from 1949 to 1963 and outside DNR fire control boundaries) the payment is \$0.20 per acre. On land entered since 1972, the payment for 2004 to 2013 is \$1.66 per acre, computed as \$0.20 times the following ratio:

$$\frac{\text{Aggregate Land Value in the State in 2002} = \$87,508,935,500}{\text{Aggregate Land Value in the State in 1972} = \$10,544,826,600} = 8.2988$$

This rate is recalculated every 10 years. The next recalculation will be made in 2012.

2. **State Contribution.** Annually, the DNR pays \$0.20 per acre to the municipality where FCL land is located. The municipality keeps 80% of this payment and shares 20% with the county.
3. **Severance Tax.** Every year, the DNR establishes values for the various types of timber harvested across the state. These values are used to calculate the value of timber harvested from FCL land. The severance tax is 10% of the value of the timber harvested, except that no severance taxes are assessed on "special provision" lands. From the proceeds, the DNR keeps an amount equal to the total payments it has made to the municipality on that parcel. Any excess is paid to the municipality, which keeps 80% of the payment and shares 20% with the county.
4. **Withdrawal Tax.** Land can be withdrawn from the FCL program at the owner's option or, if the owner violates the contract, by DNR order. Either way, a withdrawal tax must be paid. This tax equals the sum, for the years the contract was in effect, of the differences between the amount of real estate taxes that would have been levied on the land and the acreage shares and severance taxes actually paid. Each year's difference is also subject to simple (not compound) interest at 12% per year (5% for pre-1977 contracts) for each year the real estate tax has been deferred. From the proceeds, the DNR keeps an amount equal to the total payments it has made to the municipality on that parcel. Any excess is paid to the municipality, which keeps 80% and shares 20% with the county.
5. **Termination Tax.** When a contract expires and the land is not enrolled under the MFL program, a termination tax of 10% of the value of the standing timber is assessed. From the proceeds, the DNR keeps an amount equal to the total payments it has made to the municipality on that parcel. Any excess is paid to the municipality, which keeps 80% of the payment and shares 20% with the county.

### Provisions of the Managed Forest Law (MFL)

An owner of ten or more contiguous forest acres may apply for entry into the MFL program. As of April 28, 2004, the land can be in any municipality (previously, land in cities could not be enrolled). If the DNR finds that at least 80% of the parcel is actually producing or capable of producing at least 20 cubic feet of merchantable timber per acre per year, and that the land is not developed in a way incompatible with the practice of forestry, the DNR issues an order entering the land under the program. Landowners sign a 25- or 50-year contract. They must follow a forest management plan. In general, they also must permit public access for hunting and recreation. However, landowners can close up to 160 acres to public access (of which no more than 80 acres can be on land for which MFL orders took effect before April 28, 2004) by paying an annual closure fee.

1. **Acreage Share.** For MFL orders that took effect before April 28, 2004, the payment from 2004 to 2008 is \$0.83 per acre, equal to the original payment (\$0.74 per acre) multiplied by the ratio of the average statewide tax per acre on agricultural, swamp and waste, taxable forest land, and other land payable in 2002 divided by the corresponding average for 1986. For MFL orders that took effect on or after April 28, 2004, the payment for 2005 to 2008 will be \$1.46 per acre, equal to the average equalized value per assessed acre of taxable forest land in 2003 (\$1,455) times the net statewide tax rate for 2003/04 (20.0105 mills) times 5%. Both acreage share payments will be recalculated in 2007, with the revised rate effective for payments in 2009. Acreage share payments are made to the municipality, which keeps 80% and shares 20% with the county.
2. **Closure Fee.** For MFL orders that took effect before April 28, 2004, the payment from 2004 to 2008 is \$1.12 per acre, equal to the original payment (\$1.00 per acre) multiplied by the same ratio used to adjust the acreage share payment. For MFL orders that took effect on or after April 28, 2004, the payment for 2005 to 2008 will be \$5.82 per acre, equal to the average equalized value per assessed acre of taxable forest land in 2003 (\$1,455) times the net statewide tax rate for 2003/04 (20.0105 mills) times 20%. Both closure fee rates will be recalculated in 2007, with the revised rates effective for payments in 2009. The closure fee is in addition to the acreage share payment. The fee is collected by municipalities, which retain none of the proceeds. Through the property tax settlement process, all closure fees are paid to the DNR for deposit in the state Conservation Fund. DNR uses this money in its land acquisition and resource management activities.

3. **State Contribution.** The DNR pays the municipality 20 cents per year for each MFL acre. The municipality keeps 80% and shares 20% with the county.
4. **Yield Tax.** The yield (severance) tax for MFL land is 5% of the value of the merchantable timber cut. Yield taxes are assessed by and collected by the DNR. Except for FCL conversions, for MFL orders that took effect on or after April 28, 2004, the yield tax is waived on harvests in the first 5 years. Beginning on July 1, 2004, DNR remits 100% of any yield taxes to the municipality where the timber was harvested (previously, DNR retained 50% of the yield tax). The municipality keeps 80% of the payment and shares 20% with the county.
5. **Non-compliance Fee.** Effective April 28, 2004, a non-compliance fee of \$250 was established. When DNR determines that an MFL land owner has not complied with the management plan, the municipality is notified. The fee is collected by the municipality where the land is located. The municipality keeps 80% of the fee and shares 20% with the county.
6. **Withdrawal Fee.** Effective April 28, 2004, the DNR will assess a fee of \$300 on all withdrawals from the MFL program that occur before the expiration of the MFL contract period. DNR retains the entire fee.
7. **Withdrawal Tax.** On withdrawal from the MFL program during an initial order, the land owner must pay the greater of (a) the product of the net assessed value tax rate in the year prior to withdrawal times the assessed value of the land in the year prior to withdrawal times the number of years the land was under an MFL order minus the acreage share and yield taxes paid; or (b) 5% of the stumpage value of the merchantable timber on the land. On withdrawals from the MFL program on renewed MFL orders, the calculation under (a) above is made from the year of the renewal. Beginning on July 1, 2004, DNR remits 100% of any withdrawal taxes to the municipality where the land is located (previously, the DNR retained 50% of the tax). The municipality keeps 80% of the payment and shares 20% with the county.
8. **Contract Expiration.** When a contract expires and is not renewed, the land becomes subject to the property tax.

### Measuring the Tax Reduction under Forest Tax Programs

In Table 1, the tax that would have been paid on land enrolled under the forest tax laws is termed the "Initial Tax Reduction". It was estimated by (1) multiplying the average net tax per acre on taxable forest land in each municipality by the number of acres enrolled under the forest tax laws in that municipality, and (2) summing these figures across the state for each forest tax law. The amount per acre is the state total under the forest tax law divided by state total acreage enrolled under that program.

TABLE 1  
FINANCIAL ANALYSIS OF FOREST TAX LAWS, 2003/04

Item	Forest Crop Law		Managed Forest Law	
	Amount	Per Acre	Amount	Per Acre
Initial Tax Reduction	\$ 7,352,532	\$ 18.35	\$ 51,484,664	\$ 21.30
Landowner Payments:				
Acreage shares	304,402	0.76	2,006,129	0.83
Closure fees	0	0.00	1,379,614	0.57
Severance/yield taxes	244,768	0.61(*)	823,130	0.34
Termination taxes	201,028	0.50	0	0.00
Withdrawal taxes	390,770	0.98	983,074	0.41
Total Landowner Payments	\$ 1,140,968	\$ 2.84	\$ 5,191,946	\$ 2.15
Net Tax Reduction	\$6,211,564	\$ 15.50	\$ 46,292,718	\$ 19.15
Acres enrolled	400,716		2,417,023	

(\*) – The per acre figure was calculated on total acres enrolled. No severance taxes are levied on the 20,015 "special provision" FCL acres.

The "Initial Tax Reductions", for 2003 were \$18.35 per acre under the FCL and \$21.30 per acre under the MFL. Landowner payments are subtracted from the "Initial Tax Reduction" to determine the "Net Tax Reduction." As Table 1 shows, the "Net Tax Reductions," or tax savings, in 2003/04 were about \$6.2 million, or \$15.50 per acre

under the MFL and about \$46.3 million, or \$19.15 per acre under the MFL. The total net tax reduction under the programs is about \$52.5 million, or about 89% of the total initial tax reduction of about \$58.8 million.

The forest tax laws also affect property taxes indirectly through their effect on equalized values (although they are assessed every year for purposes of determining potential penalties, as tax exempt land their equalized value is zero) and the resultant effect on property tax rates. In addition, there is a redistribution of state school equalization aids compared to what would occur if there were no forest tax laws. These effects are not reflected in Table 1 and are not analyzed in this report.

## Evaluation

The number of privately owned acres enrolled under the various forest tax law programs and the average property tax on taxable forest land for selected years are shown on Table 2.

**TABLE 2**  
**ACRES ENROLLED AND AVERAGE PROPERTY TAX ON FOREST LAND, 1960 - 2001**

Year	Acres Enrolled				Average Property Tax per Acre of Taxable Forest Land
	Woodland Tax Law	Forest Crop Law	Managed Forest Law	Total Acres Enrolled	
1960	60,431	361,211	0	421,642	\$0.52
1965	107,431	490,154	0	597,585	0.56
1970	154,185	643,514	0	797,699	0.87
1975	158,302	951,808	0	1,110,110	1.42
1980	256,349	1,287,833	0	1,544,182	3.31
1985	447,851	1,468,912	0	1,916,763	5.90
1990	472,236	1,452,194	372,102	2,296,532	6.87
1995	302,338	1,406,718	804,269	2,513,325	7.76
2000	55,507	471,727	1,971,474	2,498,708	12.90
2001	0	447,673	2,079,062	2,526,735	15.73
2002	0	428,790	2,231,154	2,659,944	17.96
2003	0	400,716	2,417,023	2,817,739	20.65

Sources:

Acreage: 1960-1985: Wisconsin Department of Natural Resources, Forestry Tax Unit. 1990-2003: State totals from Statements of Assessment filed with the Wisconsin Department of Revenue.

Tax per Acre: Calculated by the Wisconsin Department of Revenue.

As noted earlier, a major purpose for enacting the forest tax laws was to promote the production of merchantable timber in the state. Although this goal has, to some extent, been accomplished, it is not known how the forest tax laws contributed to this outcome. Property taxes remain a major concern to forest land owners. With the recent increase in demand for forest land, notably for recreational and vacation home uses, forest land values and taxes are increasing significantly. For an owner of forest land interested in pursuing forestry, the forest tax laws are an increasingly attractive way to ease the tax burden. The recent changes to the MFL law which require that owners follow management plans and impose penalties for failure to follow those plans reduces the chances that an owner may use MFL as a way to reduce tax burdens while waiting to sell to a recreational or other user.

Despite the recent increases in enrollments, the forest tax laws are not reaching much of the privately owned forest land in the state. Of the 10 million acres of forest land in private ownership, only about 28% is enrolled under the forest tax laws. Some of the 72% of forest land not entered into the program is likely being used to grow a merchantable timber crop. It is not clear why those owners have not enrolled their land under the programs given the substantial reduction in taxes they would experience by doing so.

## REAL ESTATE TRANSFER FEE

### Introduction

The real estate transfer fee was enacted, effective in 1969, in response to the repeal of the federal stamp tax. It applies to transfers of real estate ownership interests located in Wisconsin.

All real estate conveyances not excluded or exempted by statute are subject to the fee. Payment of the fee is the responsibility of the seller ("grantor") of the property interest. The rate is 30 cents for each \$100 of value or fraction thereof. On conveyances that are gifts or for nominal consideration, value is the estimated price of the property had it been sold on the open market. On other conveyances, value is the full consideration paid for the property plus any liens on the property.

Value data from real estate transfer fee returns are the Department of Revenue's main source of information for determining changes in the fair market value of real property in the state. This information is used in the annual process of determining assessment/sales ratios and equalized values.

### Collections

The fee is payable to the county register of deeds when the deed or instrument of conveyance is recorded. However, the fee for land contracts is due when the land contract is recorded. Completion of a real estate transfer return and payment of the appropriate fee is usually a prerequisite for the register of deeds to record the transaction. Monthly, the county transfers 80% of the fees to the Department of Revenue. The state's share of the fees during FY04 was about \$66.3 million and counties' share was \$16.6 million.

### Analysis of Exemptions

The primary data source for the value of real estate transfers exempt from the real estate transfer fee consists of fee returns filed with the Department of Revenue in calendar year 2003 on which an exemption was claimed. A fiscal effect is difficult to estimate for some exemptions because a transfer return is not required or there is no consideration for the transfer. The fiscal effects shown below are for the portion of the real estate transfer fee paid to the state. The effect on county revenues is one-fourth of the state fiscal effect.

**TABLE 1**  
**REAL ESTATE TRANSFER FEE EXEMPTION DEVICES SUMMARY**

Exemption Device	Statutory Reference*	FY04 Fiscal Effect
Easements	s. 77.21 (1)	Not available
Leases for less than 99 Years	s. 77.21 (1)	Not available
Conveyances Prior to October 1, 1969	s. 77.25 (1)	\$16,000
Conveyances by Government Bodies	s. 77.25 (2)	286,000
Gifts to Governments	s. 77.25 (2g)	14,000
Land Dedications and Highways	s. 77.25 (2r)	2,000
Confirmation, Correction, or Reformation of Prior Conveyances	s. 77.25 (3)	2,120,000
Conveyances for Delinquent Taxes	s. 77.25 (4)	12,000
Conveyances on Partition	s. 77.25 (5)	206,000
Conveyances Pursuant to Certain Business Mergers or Reorganizations	s. 77.25 (6), (6d), (6m)	504,000
Conveyances by Subsidiary Corporation to Parent	s. 77.25 (7)	449,000
Conveyances Between Family Members	s. 77.25 (8) and (8m)	11,044,000
Conveyances Between Agent and Principal	s. 77.25 (9)	1,497,000
Conveyances to Release Debt	s. 77.25 (10)	836,000
Conveyances by Will, Descent, or Survivorship	s. 77.25 (11)	217,000
Conveyances on Condemnation	s. 77.25 (12)	142,000
Real Estate Valued at \$100 or Less	s. 77.25 (13)	21,000
Conveyances by or in Lieu of Foreclosure	s. 77.25 (14)	1,487,000
Conveyances Between Business Entities and Their Owners	s. 77.25 (15), (15m), and (15s)	4,575,000
Conveyances to Certain Trusts	s. 77.25 (16)	5,423,000
Fulfillment of Land Contract	s. 77.25 (17)	None
Transfers to a Local Exposition District	s. 77.25 (18)	None
Conveyances from a Fiduciary to an Unincorporated Nonprofit Association	s. 77.25 (20)	1,000
Electric Transmission Facilities and Land Rights	s. 77.25 (21)	None

\*References to sections of the 2003 Wisconsin Statutes.

### **Easements**

Easements are excluded from the definition of conveyances subject to the real estate transfer fee. No real estate transfer fee return is therefore required for easements.

### **Leases for Less than 99 Years**

Leases for less than 99 years are excluded from the definition of conveyances subject to the real estate transfer fee. No real estate transfer fee return is therefore required for leases of less than 99 years.

### **Conveyances Prior to October 1, 1969**

Conveyances made prior to October 1, 1969 (the date the fee went into effect) are exempt from the fee and from filing a transfer fee return. The fiscal effect is therefore understated.

### **Conveyances by Government Bodies**

Conveyances from the United States, the state of Wisconsin, or from an instrumentality, agency, or subdivision of either, are exempt from the fee. Such conveyances are also exempt from filing a real estate transfer fee return unless the governmental entity is also a lender for the transaction. Since most sales by government entities are exempt from filing a real estate transfer fee return, the fiscal effect is understated.

**Gifts to Governments**

Conveyances in the form of gifts to the United States, the state of Wisconsin, or to an instrumentality, agency, or subdivision of either, are exempt from the fee.

**Land Dedications and Highways**

Conveyances or dedication in a subdivision plat or certified survey for the purpose of a road, street, or highway to the United States, the state of Wisconsin, or to an instrumentality, agency, or subdivision of either are exempt from both the fee and from filing a transfer fee return. Because these transfers are exempt from filing a transfer fee return, the fiscal effect is understated.

**Confirmation, Correction, or Reformation of Prior Conveyances**

Conveyances that confirm, correct, or reform a conveyance previously recorded for nominal, inadequate, or no consideration are exempt from the fee.

**Conveyances for Delinquent Taxes**

Conveyances on sales for delinquent taxes or assessments are exempt from the fee and are also exempt from filing a transfer fee return. Therefore, the fiscal effect is understated.

**Conveyances on Partition**

Conveyances on partition of real estate are exempt from the fee.

**Conveyances Pursuant to Certain Business Mergers or Reorganizations**

Conveyances pursuant to mergers of corporations are exempt from the fee. Conveyances pursuant to partnerships reorganizing as limited liability partnerships are exempt from the fee. Conveyances pursuant to conversions of limited partnerships, limited liability companies, business corporations, and non-stock corporations to other forms of business are exempt from the fee if, after the conversion, the ownership interests in the new entity are identical to the ownership interests in the entity immediately preceding the conversion.

**Conveyances by Subsidiary Corporation to Parent**

Conveyances by a subsidiary corporation to its parent for no consideration, nominal consideration, or in sole consideration of cancellation, surrender, or transfer of capital stock are exempt from the fee.

**Conveyances Between Family Members**

Conveyances between husband and wife, parent and child, stepparent and stepchild, parent and son-in-law, or parent and daughter-in-law for nominal or no consideration are exempt from the fee.

**Conveyances Between Agent and Principal**

Conveyances between agent and principal or from a trustee to a beneficiary without actual consideration are exempt from the fee.

**Conveyances to Release Debt**

Conveyances to provide or release security for a debt or obligation are exempt from the fee. However, for original land contracts filed before August 1, 1992, a transfer fee will be assessed when the documents relating to fulfillment of the land contract are filed.

**Conveyances by Will, Descent, or Survivorship**

Conveyances by will, descent, or survivorship are exempt from the fee and exempt from filing a real estate transfer fee return. The fiscal effect is therefore understated.

**Conveyances on Condemnation**

Conveyances pursuant to or in lieu of condemnation are exempt from the fee.

**Real Estate Valued at \$100 or Less**

Conveyances of real estate having a value of \$100 or less are exempt from the fee.

**Conveyances by or in Lieu of Foreclosure**

Conveyances under a foreclosure or a deed in lieu of a foreclosure to a person holding a mortgage or to a seller under a land contract are exempt from the fee.

**Conveyances Between Business Entities and Their Owners**

Conveyances between a corporation and its shareholders, a partnership and one or more of its partners, or a limited liability company (LLC) and its members are exempt if the transfer is for no consideration other than the assumption of debt or stock or other interest in the business entity and all of the stock or other ownership interest is owned by persons who are related to each other as spouses, lineal ascendants or descendants, siblings, or spouses of siblings. Corporations and LLCs are eligible for the exemption only if the business entity has owned the property for at least three years.

**Conveyances to Certain Trusts**

Conveyances to a trust are exempt if a transfer from the grantor to the beneficiary of the trust would be exempt under other provisions of the real estate transfer fee law (sec. 77.25, Wis. Stats.).

**Fulfillment of Land Contract**

The recording of deeds in fulfillment of a land contract is exempt from the real estate transfer fee if the proper fee was paid when the land contract was recorded. (The fee on land contracts filed before August 1, 1992, is deferred until the contract is fulfilled. The fee on land contracts filed after July 31, 1992, is due when the contract is filed.) The intent of this provision is to prevent two fees from being imposed on the same land contract transaction. Therefore, this exemption does not reduce state revenues.

**Transfers to a Local Exposition District**

Transfers of property to a local exposition district organized under Subchapter II of Chapter 229, Wis. Stats., are exempt from the fee.

**Conveyances from a Fiduciary to an Unincorporated Nonprofit Association**

Conveyances from a fiduciary which held property for the benefit of an unincorporated nonprofit association to the unincorporated nonprofit association in the association's own name are exempt.

**Electric Transmission Facilities and Land Rights**

Conveyances of transmission facilities or land rights for transmission facilities by a utility company to a transmission company in exchange for securities in the transmission company are exempt from the real estate transfer fee.

## TAXATION OF PUBLIC UTILITIES

### Background

Until the early 1900s, each municipality valued and taxed public utility property located within its borders. In 1905, the state began valuing and taxing railroad property under the "unitary" concept whereby each railroad was valued as a whole, as opposed to separate values in each municipality. In addition, railroad taxes were calculated using the state average tax rate instead of local tax rates. In 1908, street railway companies and associated light, heat, and power companies were brought under state taxation. In 1917, other light, heat, and power companies with property in more than one municipality were brought under this system. Light, heat, and power companies were taxed at local rates until 1929, when the state average rate was applied. This system of taxation was extended to airlines in 1946 and to pipelines in 1950.

Some utilities are taxed on the basis of their gross receipts instead of their property. Rural electric cooperatives, created in the 1930s, were originally taxed on their property. In 1939, they were switched to a tax based on gross revenues. In 1985, private light, heat, and power companies were switched to a tax based on gross revenues. Telephone companies were taxed on their gross revenues until 1998, when they began a switchover, completed in 2000, to a property tax.

Special rules apply to a utility whose property is located in a single municipality. A utility whose primary business is the retail sale of electricity and which has all of its property and customers in one municipality is taxed locally under the general property tax. A utility whose primary business is the wholesale sale of electricity is taxed locally under the property tax if its generating capacity is less than 50 megawatts and taxed under the state gross revenues tax if its generating capacity is 50 megawatts or more.

Total state utility tax collections in FY04 were \$290 million. Taxes on railroads and airlines were deposited in the transportation fund; other utility tax collections, totaling \$270 million, were general purpose revenues and accounted for 2.5% of GPR taxes. Table 1 shows utility tax collections in FY04 for gross revenues and ad valorem taxpayers.

**TABLE 1**  
**FY04 UTILITY TAX COLLECTIONS**

Utility by Type of Tax	Collections
<b>Gross Revenues</b>	
Carlines	\$ 419,564
Electric Cooperative Associations	8,485,908
Municipal Light, Heat, and Power	1,813,396
Private Light, Heat, and Power	165,436,362
<b>Ad Valorem - Unit Value</b>	
Airlines	8,194,672
Conservation and Regulation Companies	91,845
Municipal Electric Association Projects	1,295,645
Pipelines	10,555,169
Railroads	11,923,323
<b>Ad Valorem – Tangible Property Value</b>	
Telephone Companies	81,587,146
<b>TOTAL</b>	<b>\$289,803,030</b>

### Taxation Methods

Under the gross revenues tax, a company's tax liability is its gross revenues allocated to Wisconsin multiplied by a specified tax rate. Carlines are taxed at 3% of their gross revenues. Rural electric cooperatives are taxed at 3.19% of their retail gross revenues. Private light, heat, and power companies are taxed at 0.97% of their revenues from gas services and 3.19% of their retail gross revenues from electric and other services (primarily steam and water). For rural electric cooperatives and private light, heat, and power companies, the tax rate on gross revenues from wholesale electric sales from 2004 to 2009 will be 1.59%.

Under the ad valorem tax, utilities other than telephone companies are taxed on the basis of the portion of their unit value allocated to Wisconsin. This method is applied to railroads, airlines, pipelines, and conservation and regulation companies. Municipal electric association projects (power systems owned by two or more municipal light, heat, and power companies) make an in-lieu of tax payment based on this method. The utility's value allocated to Wisconsin is multiplied by the net statewide average tax rate to determine the utility's tax liability. The net statewide average tax rate is calculated by dividing the total statewide property taxes levy minus the school levies credit by the statewide full market value of taxable property.

Under the telephone property tax, the real and tangible personal property of each telephone company in each municipality is taxed at the prior year's net tax rate applicable in that municipality.

**TABLE 2  
PUBLIC UTILITIES TAX EXEMPTION DEVICES SUMMARY**

Exemption Device	Statutory Reference *	FY04 Fiscal Effect
<b>Gross Revenues Exemptions</b>		
Power Purchased by Private Light, Heat, and Power Companies	s. 76.28 (1) (d)	\$ 1,177,000
Power Purchased by Electric Cooperatives	s. 76.48 (1g) (d)	4,499,000
Public Benefits Charges	ss. 76.28 (1) (d) and 76.48 (1g) (d)	22,000
Transmission Company Revenues from Wisconsin-taxed Utilities	s. 76.28 (1) (d)	5,709,000
<b>Ad Valorem Exemptions</b>		
Hub Airlines	s. 70.11 (42)	2,500,000
Motor Vehicles – Generally	s. 76.025 (1)	273,000
Motor Vehicles – Telephone Companies	s. 76.81	Not available
Treatment Plant and Pollution Abatement Equipment – Generally	s. 76.025 (1)	275,000
Treatment Plant and Pollution Abatement Equipment – Telephone Companies	s. 76.81	None
Computers – Generally	s. 76.025 (1)	150,000
Computers – Telephone Companies	s. 76.81	950,000
Fax Machines and Cash Registers – Generally	s. 76.025 (1)	Not available
Fax Machines and Cash Registers – Telephone Companies	s. 76.81	Minimal
Telephone Company Property Used Less Than 50% for Telephone Purposes	ss. 70.112 (4) (b) and 76.81	Minimal

\* References are to the 2003 Wisconsin Statutes.

## GROSS REVENUES EXEMPTIONS

### Power Purchased by Private Light, Heat, and Power Companies

Private light, heat, and power companies may deduct from their gross revenues tax base an amount equal to the following percentages of their cost of power purchased for resale:

- 100% if:
  - the company purchased more than 50% of the power it sells, and
  - the power was not purchased from a company with an "affiliated interest" (i.e., neither company may have an ownership interest in the other), and
  - the revenue from the purchased power was included in the seller's gross revenue as reported to the Wisconsin Public Service Commission (i.e., the seller is subject to Wisconsin's gross revenues tax).
- 50% if:
  - the company purchases more than 90% of its power, and
  - the company has less than \$50 million of gross revenues.

**Power Purchased by Electric Cooperatives**

Electric cooperatives may deduct from their gross revenues the cost of power purchased for resale if the cooperative meets one of the following tests:

- The cooperative purchases more than 50% of the power it sells, and the revenue from the purchased power is included in the seller's gross revenues, or
- The cooperative purchased more than 50% of the power it sold in 1987 from a seller located outside Wisconsin.

**Public Benefits Charges**

Beginning in September 2000, private light, heat, and power companies' responsibilities for providing public benefits programs such as low-income energy assistance, energy conservation, and renewable energy assistance programs were transferred to the state. Funding for these programs is provided by a state-mandated public benefits charge on monthly utility bills. Utility companies remit the fees collected to the state. These public benefits charges are excluded from the revenues subject to the gross revenues tax. Since the fee is paid to the state, there is no state revenue loss.

Electric cooperatives and municipal electric companies can participate in the state program or operate their own public benefits programs. In either case, the programs are funded by a state-mandated public benefits charge on monthly utility bills. These public benefits charges are excluded from the revenues subject to the gross revenues tax. If the entity participates in the state program, fee collections are remitted to the state and there is no state revenue loss. If the entity operates its own program, there is a state revenue loss equal to the amount of the public benefits charge times the tax rate applicable to the utility service.

**Transmission Company Revenues from Wisconsin-taxed Utilities**

When calculating its gross revenues, a transmission company may exclude revenues for services provided to: (1) electric cooperatives organized under Wisconsin law that provide wholesale service to their members, (2) municipal light, heat, and power companies based in Wisconsin, and (3) private light, heat, and power companies which are subject to the state's gross revenues tax.

**AD VALOREM EXEMPTIONS****Hub Airlines**

2001 Wisconsin Act 16 exempted property of a "hub airline" from the state ad valorem tax on airlines and from local property taxes. An airline qualified as a "hub airline" if in the prior year it (1) operated at least 45 common carrier flights each weekday to at least 15 non-stop destinations from a single airport in Wisconsin; or (2) it was headquartered in Wisconsin and operated, from single airport or combination of Wisconsin airports, at least 20 common carrier flights each weekday. Exempt airlines are not required to file financial reports with the Department of Revenue. Based on public financial reports filed with the Securities and Exchange Commission and other public reports, the revenue loss in FY04 is estimated to be \$2,500,000.

In a November 2003 decision by the Dane County Circuit Court, this exemption was held to be unconstitutional. The decision is currently under appeal.

**Motor Vehicles – Generally**

Motor vehicles such as automobiles, trucks, and trailers owned by airline, pipeline, railroad, or conservation and regulation companies are exempt from the ad valorem utility tax but subject to registration fees in the same manner as other motor vehicles.

**Motor Vehicles – Telephone Companies**

Motor vehicles owned by telephone companies are exempt from the telephone company property tax but subject to registration fees in the same manner as other motor vehicles. Telephone companies do not report the value, number or type of motor vehicles. Therefore, an estimate of the revenue effect of this exemption is not available.

**Treatment Plant and Pollution Abatement Equipment – Generally**

Property owned by airline, pipeline, railroad, or conservation and regulation companies used as a waste treatment facility to abate or eliminate the pollution of the water or air of the state is exempt from the ad valorem utility tax.

**Treatment Plant and Pollution Abatement Equipment – Telephone Companies**

Property owned by telephone companies used as a waste treatment facility to abate or eliminate the pollution of the water or air of the state is exempt from the telephone company property tax. Telephone companies did not own any such property in FY04.

**Computers – Generally**

Computers owned by airline, pipeline, railroad, or conservation and regulation companies are exempt from the ad valorem tax. The exemption may be slightly overstated since those fax machines and cash registers which are also exempt are generally included schedules for computers when reported to the Department.

**Computers – Telephone Companies**

Telephone company computers that are used for general business purposes are exempt from the telephone company property tax.

**Fax Machines and Cash Registers – Generally**

Beginning in 2003, cash registers and fax machines, excluding fax machines that are also copiers, owned by airline, pipeline, railroad, or conservation and regulation companies are exempt from taxation. This equipment is not separately reported, but is generally included with computers on utility reports filed with the Department. An estimate of the effect of this exemption is therefore not available.

**Fax Machines and Cash Registers – Telephone Companies**

Beginning in 2003, cash registers and fax machines, excluding fax machines that are also copiers, owned by a telephone company are exempt from taxation.

**Telephone Company Property Used Less Than 50% for Telephone Purposes**

Beginning in 2003, property that is used less than 50% in the operation of a telephone company is exempt from the telephone property tax. However, such property is subject to local property taxes.